92-1384

No. (2)

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

BARCLAYS BANK PLC
Petitioner,

vs.

FRANCHISE TAX BOARD,
An Agency of the State of California
Respondent.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA IN AND FOR THE THIRD APPELLATE DISTRICT

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SUPERIOR COURT OF CALIFORNIA, COUNTY OF SACRAMENTO

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Plaintiff,
vs.
FRANCHISE TAX BOARD,
an Agency of the State of California,
Defendant.

BARCLAYS BANK OF CALIFORNIA,
a California corporation,
Plaintiff,
vs.
FRANCHISE TAX BOARD,
an Agency of the State of California,
Defendant.

No. 325059
No. 325061
(Consolidated for Purposes of Trial)

ENDORSED:
Filed August 20, 1987

JOYCE RUSSELL SMITH, CLERK
By S. GODFREY, Deputy

STATEMENT OF DECISION

The Court hereby adopts in full its "INTENDED DECISION" of June 16, 1987, and hereby files it as attached hereto, as the Court's "STATEMENT OF DECISION".

DATED: August 20, 1987.

GEORGE E. PARAS
Judge of the Superior Court
Pro Tem

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LTC.,
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vs.
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an agency of the State of California,
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INTENDED DECISION

I
STIPULATED FACTS

Pursuant to written stipulation of the parties (Exhibits 1 and 2), the facts therein stipulated are found to exist. Said stipulations are attached hereto as Schedules 1 and 2 respectively. Additional findings of fact on disputed matters are made during the course of this Intended Decision.

II
JURISDICTIONAL ISSUE

Defendant Franchise Tax Board (FTB) renews its jurisdictional claim (denied on a motion in limine [RT Page 136-138] at the outset of the trial) that because Plaintiffs assertedly failed to mention in their protest (the procedural equivalent here of a "claim") that a basis thereof was unconstitutionality deriving from interference with the *Federal Executive Branch's* conduct of foreign affairs, they are precluded from relief on that basis at trial. This issue is again resolved against Defendants on two grounds; first, the protest and proceedings thereon did give adequate notice, and second, if the tax as here applied is unconstitutional on any ground the FTB did not have jurisdiction so to adjudicate it, hence the presentation of such a specific claim would have been a futile act. This ruling is fortified by *Park 'N Fly of San Francisco, Inc. v. South San Francisco* (1987) 188 Cal App 3d 1201.

FTB's request for judicial notice of Friendship, Commerce and Navigation (FCN) Treaties with France, the Federal Republic of Germany, Japan, and the Netherlands is granted.

III
JAPAN LINE, CONTAINER, AND WARDAIR CASES

Three U. S. Supreme Court Cases decided within the past eight years are absolutely vital to the position of both parties. They are *Japan Lines Ltd. v. County of Los Angeles* (1979) 441 U.S. 434, *Container Corporation of America v. Franchise Tax Board* (1983) 463 U.S. 159, and *Wardair Canada v. Florida Department of Revenue* (1986) 477 U.S. ____; 106 S.Ct. 2369.

Before I can rule on the various contentions it seems to me essential that I analyze and offer my interpretation of each decision, both as it affects this case and as it affects the other two. I do this with unqualified respect for contrary interpretations by the parties and by others. We are in a highly complex area of constitutional law, so complex that it's exposition in a given case necessarily occasions varying nuances of judicial expression and intendment, not all of which are or can be perceived identically by every reader and some of which are themselves at times not totally consistent. Even so, it is hopeless to undertake a resolution of the issues here without a basic exposition of the legal significance of these three cases as seen by this Court.[1]

A. *JAPAN LINE*

The first case in the trilogy involved an ad valorem property tax by Los Angeles County on large containers owned and used by Japanese companies in connection with their international marine shipments of goods strictly in foreign commerce. The containers only "stopped off" for short periods at foreign (to Japan) ports like Los Angeles in the course of their international journey. The Supreme Court invalidated the tax on foreign commerce constitutional grounds.

Initially it is notable that the Court's analysis did not involve due process and the 14th Amendment (441 U.S. at 439, FN. #3); thus it can be of no help to us here as to Plaintiff's due process claim. Nor did it address the question of participation of the Executive Branch in the conduct of foreign affairs; thus, it is of no assistance in resolving that issue either.

The Court might have grounded its holding on the common law "Home Port Doctrine" (*Hays v. Pacific Mail S. S. Co.*, (1985) 17 How. 596), but expressly refused to do so (441 U.S. at 442-444), saying: "The question here is a . . . narrow one, that is, whether instrumentalities of commerce that are owned, based, and regis-

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[1]It goes without saying that *Japan Line*, *Container* and *Wardair* are not the only authorities affecting this decision. The multitude of other cases have been studied and considered, and appropriately enter into the result.

tered abroad, and that are used exclusively in international commerce, may be subjected to apportioned ad valorem property taxation by a State." Rather the court moved directly into the Commerce Clause, Article I Section 8, Cl. 3 of the Federal Constitution. It reviewed its own holdings regarding state taxes in the interstate commerce area, including "instrumentalities of interstate commerce", and reiterated the applicable four pronged test for determining constitutionality (substantial nexus, fair apportionment, non-discrimination, and fair relation) as enunciated in *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, and *Washington Revenue Dept. v. Association of Wash. Stevedoring Cos.* (1978) 435 US 734. Rejecting the taxing authority's contention that the Commerce Clause analysis is identical in a foreign as well as an interstate context, it stated that "[w]hen construing Congress' power to regulate commerce with foreign nations', a more extensive constitutional inquiry is required." (441 US at 446) It then enunciated the now firmly established and accepted two additional criteria, enhanced risk of multiple taxation and potential impairment of federal uniformity in areas in which such uniformity is essential (441 US at 446 to 451).

As to the first criterion, the Court stressed the absence of any authoritative tribunal capable of ensuring against a double tax burden in the international area, in contrast with its own power so to ensure in the interstate area. It indicated the foreign country of domicile of an instrumentality of commerce "*may* have the right *consistently with the custom of nations* to impose a tax on its full value. [fn omitted] If a state should seek to tax the same instrumentality on an apportioned basis, *multiple taxation inevitably results.*" (emphasis added) (441 US at 447). "A . . . state tax, even though 'fairly apportioned' . . . *may* subject foreign commerce to the *risk* of a double tax burden to which (domestic) commerce is not exposed, and which the Commerce Clause forbids' ". (emphasis added) (441 US at 448). The Court pursued this point by indicating the ad valorem tax created more than the *risk* of double taxation; based on a stipulation and a trial court finding, Japan in fact taxed the same items at full value, hence there was an undeniable double tax (thus the Court did not elaborate on what circumstances would cause the mere *risk* of double tax to come into play constitutionally) (441 US at 452,

incl. FN 17). To the assertion that it is Japan's levy that creates the double tax, not California's (Los Angeles County's), the Court responded with "California's tax, however, *must be evaluated in the realistic framework of the custom of nations.* Japan has the right and the power to tax [the] containers at their full value; nothing could prevent it from doing so." (emphasis added) (441 U.S. at 454.) Similarly it rejected a claim that since Congress has not acted a State may act, in favor of a Dormant Commerce Clause concept, stating "California may not tell this nation or Japan how to run their foreign policies" (441 U.S. at 454-455). Finally, the Supreme Court distinguished *Moorman Mfg v. Bair* (1978) 437 U.S. 267, on the basis primarily that it concerned interstate commerce, but confirmed in the process "that the Commerce Clause 'does not call for mathematical exactness nor for the rigid application of a particular formula; only if the resulting valuation is palpably excessive will it be set aside.'" (441 U.S. at 455).

As to the second criterion, the Supreme Court stressed the concept that the Foreign Commerce power of Congress is greater than its Interstate Commerce power, emphasizing "the need for uniformity in treating with other nations" and "the framers overriding concern that 'the federal government must speak with one voice when regulating commercial relations with foreign governments'" (441 U.S. at 448-449). The Court gave illustrations of how the subject tax *may* frustrate federal uniformity, as by resulting international disputes over reconciling apportionment formulae, by retaliation from other nations to the detriment of the United States as a whole, and by other states of the United States than California also taxing the same subject, "a result which would plainly prevent this nation from 'speaking with one voice' in regulating foreign commerce." (441 U.S. at 450-451). The Court cited the mutual participation of the United States and Japan in the Customs Convention on Containers as the source of desirability for uniform treatment of containers; the Convention stated that containers temporarily imported are free from "all duties and taxes whatsoever", a national policy of federal uniformity that the subject tax will frustrate. The Court brought into the case an element of "reciprocity" by indicating that since American-owned containers are not taxed in Japan, the tax creates an

asymmetry to Japan's disadvantage, thereby creating an acute risk of Japanese retaliation (441 U.S. at 452-453). A form of nascent immediate and direct retaliation was recognized by the Court, the European Economic Community's determination to consider "suitable counter-measures" when informed of California's tax.

Several further observations on the *Japan Line* decision are in order. On first reading, it appears to hold rather unequivocally that the four requirements for interstate tax validity are met. On more careful reading however it is seen that the *Japan Line* Court only assumes, without deciding, that the requirements are satisfied so that it may proceed to the foreign affairs discussion (441 U.S. at 445, 451). This is important to us only with reference to the claim by the Plaintiffs that the four interstate standards have not fully been met (POB Page 154-162) and the FTB's counter argument that they have been met as a matter of law (DB Page 17-21). *Japan Line* does not foreclose Plaintiffs from pursuing their position in this regard.

Japan Line deals with a tax on an "instrumentality of commerce", foreign commerce. It does not tell us whether a foreign parent of a domestic corporation or a foreign corporation doing business in California is an instrumentality of commerce that must be determined from other authorities.

Japan Line involved a tax on tangible personal property not income, a more abstract form of property. Seizing on this difference, one can argue that all the *Japan Line* pronouncements are dicta as they apply to this case. In the judicial sphere what is dictum and what is legal pronouncement are more frequently than not determined by later judicial inclination. The *Japan Line* doctrines were however treated as law, not dicta, by the *Container court* (see infra). There is a distinction, for obviously there are differences between a cargo container and a corporate entity; and certain legal principles applicable to one need not apply to the other. But to the extent that the U.S. Supreme Court makes special pronouncements on a subject which readers find reasonably applicable to a variation of the subject or to a wholly different subject, those pronouncements are, to this judicial officer at least, controlling law; only the Supreme Court itself should declare them inapplicable as dictum or otherwise.

The case is very strong in its expressions regarding sensitivity of foreign affairs to any intrusions by individual states. Although finding the existence of an actual double taxation, it clearly applies its rule of law to potential double taxation depending upon appropriate "considerations", which it does not define except that they must constitute a substantial burden on foreign commerce (although any burden thereon is suspect). It is almost insistent in its demand that in foreign matters, at least with specific aspects thereof, the federal government alone be involved (one voice). As to its judicial effect upon a unitary tax case such as FTB's, assuming the context of a foreign corporation doing domestic business either directly or through a subsidiary, *Japan Line* is strongly supportive of Plaintiff's foreign commerce claim. It recognizes the "custom of nations" as a significant foreign affairs concept. It reaffirmed the Dormant Commerce Clause principle. It viewed as significant in the foreign affairs context the role of reciprocity (a tax by foreign nations on American companies or property balanced by a comparable American tax on foreign companies or property) and the correlative concept of asymmetry.

B. *CONTAINER*

This decision is so very close to the present case that its every aspect must be examined carefully for its effect hereon. It involved the same State (California), the same agency (Franchise Tax Board), and the same tax (income). The sole juridical difference is that it involved a domestic parent corporation (Delaware — headquartered in Illinois), with foreign subsidiaries doing business and being taxed in California; while here we have a foreign (United Kingdom [UK]) parent corporation whose foreign (UK) subsidiary, directly and through its California subsidiary (Barclays Bank of California [BARCAL]) did business in California and was naturally subject, as was BARCAL, to California income taxation. The specific issue of constitutionality of the application of California's unitary taxation method, known also as World Wide Combined Reporting (WWCR) to a Barclay type business group was reserved expressly by *Container* (463 U.S. at 189, FN 26 and 19[illegible] FN 32). Three questions were presented literally to the *Container* Court for its review: (1) Whether the business group was properly a

"unitary business" for purposes of the tax, (2) If so, did the WWCR method as applied to the Container network of corporations violate the constitutional requirement of "fair apportionment"? And (3) Did California have an obligation under the Foreign Commerce Clause to employ the "arms-length" method used by the Federal Government? (463 U.S. at 165). Though the Supreme Court thus phrased the third question, it is but another way of asking whether WWCR was constitutionally appropriate. *Container* held that the group there involved was properly "unitary", that the apportionment was fair, and that the use of WWCR did not violate the Foreign Commerce Clause.

Here there is no issue of whether the Barclay group is properly a unitary group, that question having been conceded by the Plaintiffs for purposes of this case.[2] *Container's* discussion thus affects us as to its second and third questions. It is notable however that *Container* reaffirmed the general rule that under both the Due Process and Commerce clauses a state may not "tax value earned outside its borders" when imposing an "income-based" tax. But because businesses operating across state lines make precise territorial allocations of value impossible, States have been permitted constitutionally to use "formulae" for apportionment, with the taxpayer having the distinct burden of showing by "clear and cogent" evidence that a challenged tax falls on extraterritorial values (463 U.S. at 164).

On the question of fair apportionment, *Container* emphasized the taxpayer's burden to prove that the income apportioned to itself by the taxing entity and its methodology is "out of all appropriate portion to the business transacted" within that entity (463 U.S. at 180-181). In this regard the Court noted the argument that the foreign subsidiaries are significantly more profitable (that argument also is made here by Plaintiffs — POB Page 149-154), and California's three factor formula systematically distorts the true allocation. Citing *Mobile Oil Corp. v.*

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[2] There is a secondary issue however as to whether within the rubric of determination of the unitary group and application of an apportionment formula to it, the formula is "fair" (463 U.S. at 169 — POB Page 154 et seq.). It will be addressed in due course.

Commissioner of Taxes (1980) 447 U.S. 207, the Court rejected this argument in the face of considerable evidence supporting such distortion; such evidence "does not by itself come close to impeaching the basic rationale of the three factor formula" (463 U.S. at 182). As an example of a distortive effect "outrageous" enough to sustain the taxpayer's burden, the Supreme Court presented a formulary attribution of 66% to 85%, struck down in *Hans Rees' Sons, Inc. v. North Carolina Ex. Rel. Maxwell* (1931) 283 U.S. 123, compared to below 21.7% under a separate accounting analysis in *Container* (463 U.S. at 180-181). Observing that the percentage increase in *Container's* facts from the taxable income as filed to the taxable income as revised by WWCR was but 14% compared to over 250% in *Hans Rees'*, the Court concluded on this issue that the 14% figure was "certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business" (463 U.S. at 184). The evidence in this case (Barclay) indicates that the final tax figures for 1977 after the protest procedure resulted in a combined tax increase for both Barclays Bank International Ltd. (BBI) and BARCAL from an aggregate of $555,724.03 to $859,822.03, a difference of 28%; the taxable income figures are comparable. Given the strong language of *Container* on the issue of fair apportionment and the very heavy burden placed upon the taxpayer on this issue, coupled with the fact that the *Container* Court had before it and considered substantially the same evidence as was presented here (except perhaps the evidence on costs of compliance), I conclude that the use of WWCR here did not apportion income to BBI and BARCAL in an amount "out of all appropriate proportion to the business transacted" in this State. I make the same ruling with regard to Plaintiffs' claim of unfairness of the formula per se as applied to foreign multi-state corporations. While *Container* has its two "fairness" concepts, one respecting the formula (463 U.S. at 169) and the other respecting the apportionment (463 U.S. at 180), I discern no appreciable difference between the two. The opinion discusses both in the context of the "all appropriate proportion" burden. Moreover I do not conclude that cost of compliance is a factor entering into the fair apportionment and fair formula rules, which in my opinion focus upon the tax itself and its treatment of

multiple entity income, not with the taxpayer's burden or cost. To the extent therefore that Plaintiffs claim unconstitutionality of the use of WWCR on grounds of fairness or fair apportionment, my decision is in favor of FTB.

The *Container* case proceeded to the "additional scrutiny required by the foreign Commerce Clause .... The case most relevant ... is *Japan Line*." (463 U.S. at 185). This disposes undeniably of any potential claim that *Japan Line* is distinguishable and not controlling as to its enunciation of certain principles of law because it involved a property and not an income tax. The Supreme Court certainly did not so consider it, although it was mindful of its factual basis.

The Court found four important similarities to *Japan Line*, (1) There was actual double taxation by California and foreign nations in both cases (which FTB does not here seriously dispute), (2) The double tax stems from seriously divergent taxing schemes of the taxing authorities, (3) The foreign taxing scheme is consistent with "accepted international practice", and (4) The Federal Government "seems to prefer" the international (arm's length) taxing method (463 US at 187). The Court also found three clear distinctions from *Japan Line*, (1) *Japan Line* involved a property tax, (2) the double tax in *Container* is not the inevitable result of California's tax scheme, and (3) the tax does not fall on the "foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States." (463 US at 188) Referring to its reservation of the *Japan Line* holding's application to "domestically owned instrumentalities engaged in foreign commerce," it then stated "... to the extent that corporations can be analogized to cargo containers in the first place — this case falls clearly within that reservation" (463 US at 188-189).[3]

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[3]This disposes to my satisfaction of the question of a corporation being or not being an "instrumentality of commerce." Despite disagreement on this question (DB p. 45-46), the quoted statement from Container makes it clear, along with the rest of the opinion, that a corporation for legal and constitutional purposes is treated as an instrumentality of commerce, whether actually it is or not.

The court went on to expatiate on the similarities and dissimilarities to *Japan Line*. It reaffirmed the literal *Japan Line* expression that "even a slight overlapping of tax — a problem that might be deemed *de minimis* in a domestic context — assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." Taking into account the context of the *Container* tax, which the rule itself requires, and the fact that even the adoption of an arm's length method would not guarantee an end to double taxation, the Court found the rule not determinative (463 US at 189-193), pointing out here again the distinction between a property tax and an income tax (463 US at 192).

Proceeding to *Japan Line's* impairment of uniformity and speaking with one voice concepts, the Court uttered the phrase: "In conducting this inquiry . . ., we must keep in mind that if a state tax merely has *foreign resonances*, but does not *implicate* foreign affairs, we cannot infer, 'absent some explicit directive from Congress . . . that treatment of foreign income at the Federal level *mandates identical treatment* by the States.'" (Emphasis added) (463 US at 194). The Court continues: ". . . a state tax at variance with Federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear Federal directive [a species of pre-emption]." (463 US at 194) Here the Court went on to explain its problem, that as a Court (presumably in the absence of specific evidence) it has little competence in determining when a foreign government is or will be offended and in how to balance a risk of retaliation against the sovereign right of the United States to let States tax as they please. "The best we can do . . . is to attempt to develop objective standards . . . about the imperatives of international trade and . . . relations." (463 US at 194). For three reasons, the Court concluded against the possibility of justifiable foreign retaliation, first there was no automatic asymmetry in *Container* second the tax was imposed not on a foreign entity but on a domestic corporation ("The legal incidence of the tax falls on the domestic corporation"), and third the California tax rate could be raised, thereby having the same financial foreign effect; and whether so or no, the offense to the foreign entity would be attenuated (463 US at 194-195). With reference to the

second reason, the Court inserted a footnote pointing out that this tax effect on a domestic corporation "might be less significant if the domestic corporation was owned by foreign interests".

The Court then noted the absence of a United States Amicus Curiae Brief, which though not dispositive was suggestive that United States foreign policy ("whose nuances . . . are much more the province of the Executive Branch and Congress than of this Court") was not seriously threatened by California's WWCR (463 US at 196). This clarifies the role of the United States as an Amicus — its presence in that capacity is not merely as a traditional "friend of the Court" with the Attorney General as its lawyer, but is a substantive exposition of the Executive's view of foreign affairs implications in this unique type of case. Were it otherwise as a matter of the Supreme Court's law, the *Container* court would not have mentioned it in so positive a way. This judicial statement also is an indication of the significant role of the Executive in foreign affairs, confirming that despite the literal language of Article I, Section 8, Cl. 3, giving *Congress* control over foreign affairs, that control is shared between the Congress and the Executive (with Congress supreme as between the two). There is no truly serious disagreement on this between the parties, although they expectably disagree as to its application in this case.

After thus concluding that foreign affairs were not implicated by California's unitary tax in a domestic corporation context, the *Container* Court went on to the final consideration that a "clear Federal directive", if present and proscriptive of WWCR, would have voided the latter's use by the FTB. It found none. There was no Federal statute, despite long debates in Congress. The numerous Tax Treaties of the United States require it to adopt some form of arm's length analysis in taxing the domestic income of multinational enterprises, but "that requirement is generally waived with respect to the taxes imposed upon each of the contracting parties on its own domestic corporations. This fact, if nothing else, confirms our view that such taxation is in reality of local rather than international concern." (463 US at 196). The tax treaties do not apply the arm's length requirement to the States. Finally, the Senate "reserved" a clause making the re-

quirement applicable to the States in the process of ratifying the 1977 US-UK Treaty.

By way of general commentary on the case, it appears that *Container* receded somewhat from the stronger one voice position of *Japan Line*. Where *Japan Line* was almost eager to anticipate retaliation, *Container* professed practical impotence on the subject. The very large emphasis of the case in distinguishing *Japan Line* was in two areas, the income vs. property tax distinction and the domestic vs. foreign corporate tax effect. The foreign commerce power was recognized as exercisable and exercised by both the Executive and Legislative branches. The Tax Treaties and their content were considered. The Senate's reservation of Clause 9(4) from the US-UK Tax Treaty of 1977 was mentioned to suggest an absence of intention by Congress to occupy the State tax field.

C. *WARDAIR*

Florida imposed a sales tax on aviation fuel purchased within its boundaries by Wardair, a Canadian corporation which operates charter flights between Canada and the United States. Wardair claimed the tax was precluded by the Foreign Commerce Clause and a clear directive of Congress implicit in the Federal Aviation Act (FAA). The Supreme Court held, "We disagree . . . and find that Congress has not acted to preempt state taxes such as that imposed by Florida. Accordingly we affirm. . . ." (106 S.Ct. at 2370).

Congress has not occupied the field by enacting the FAA, states the Court. Where a Federal statute does not expressly preempt a state law and there is no actual conflict between the two laws, "we have required that there be evidence of a Congressional intent to pre-empt the specific field covered by the state law" (106 S.Ct. at 2372). Instead of precluding this tax, the FAA expressly permits it, but in general terms ("taxes on the sale of goods and services"). But it may be that Congress didn't consider in the FAA that *foreign* carriers could be taxed, so the Court did not rely on that enactment to answer the Commerce Clause issue; but it answered Wardair's pre-emption argument (Ibid).

The Court then turned to Dormant Commerce Clause considerations, explaining that this doctrine is grounded on the absolute need for uniformity even where Congress has not acted (106 S.Ct. at 2373). It reviewed the four basic tests involved in interstate (and foreign) commerce matters and the additional two that must be considered where foreign commerce is involved. The first four tests were not involved in the case; nor the first of the next two, because no double tax existed in a "discrete" sales tax context. Only the last, the one voice test, was involved, with Wardair and the United States (as Amicus, through the Solicitor General) urging the existence of a Federal policy in the taxation of instrumentalities of international air traffic. The Supreme Court disagreed, holding that the evidence showed no such Federal policy but on the contrary a policy *permitting* such taxation, so that no Dormant Commerce Clause discussion at all was needed (106 S.Ct. at 2373-2374).

From a study of the Chicago Convention on International Civil Aviation of 1944, a 1966 "Resolution" of the International Civil Aviation Organization, and more than 70 bilateral agreements (to all of which the United States was a party), the Court concluded that while there is an international *aspiration* to eliminate a fuel tax, the law currently *acquiesces* in such tax by political subdivisions of countries. The Chicago Convention demonstrates international awareness of the problem of state and local taxation of aviation fuel and a decision to limit it in some respects but not this one. The Resolution, while clearly opposing such a tax, has not been "signed, entered into, agreed upon, approved or passed by either the Executive or Legislative branch of the Federal Government"; it is merely the work product of an organization of which the United States is a member. It is not a policy of the United States (106 S.Ct. at 2374-2375).

The *Wardair* Court notes that since the Chicago Convention, the United States became a party to each of the over 70 bilateral agreements, all of which forbid federal taxes on aviation fuel but none of which, including the one with Canada eight years after the Resolution, interdict it at the local level. "By negative implication arising out of more than 70 agreements entered into since the Chicago Convention, the United States has at least

acquiesced in state taxation of fuel used by foreign carriers in international travel." This is an affirmative decision to permit this tax (106 S.Ct. at 2375).

Wardair adds to our understanding of the Supreme Court's teachings in the area of state taxation of foreign commerce the following. Federal policy in a given area of foreign affairs may be found by negative implication from a series of international agreements entered into by the United States (presumably negotiated and executed by the Executive and ratified by the Senate) with knowledge of a specific problem or concern, in which the latter is ignored, while focusing on another, but related, problem. Federal policy will not be found by mere membership in an international organization which itself expresses a policy on a subject of international concern.

IV

RESOLUTION OF ISSUES

Plaintiffs divide their post-trial briefing arguments into four headings, (1) WWCR infringes upon the exclusive power of the Federal Government to deal with foreign affairs; (2) WWCR violates the Supremacy Clause (pre-emption); (3) WWCR impermissibly burdens commerce; (4) WWCR discriminates against foreign commerce and is internally inconsistent, in violation of the Commerce and Due Process clauses; and (5) as applied to foreign based unitary groups, WWCR deprives them of property without due process. FTB argues (1) Plaintiffs have not sustained the burden of proving both illegality of FTB's tax *and* the correct amount if Plaintiffs are correct; (2) Plaintiffs are barred as to the foreign affairs issue by failure to exhaust administrative remedies; (3) Congressional foreign policy prevails over that of the Executive; (4) *Container* and *Wardair* compel judgment in FTB's favor; (5) even under a Dormant Foreign Commerce clause analysis, WWCR is not a violation; (6) Plaintiff's burden on cost of compliance with WWCR as a Constitutional violation has not been met; (7) FTB's procedures on WWCR do not violate due process; and (8) this court has no jurisdiction to impose a "Water's Edge" rule on FTB. A ruling adverse to FTB's

second point has heretofore been made; the others remain. Considerable overlap is noted between and among a number of the contentions of both parties. It is inevitable, for as heretofore observed specifically with a segment of the *Container* case, the various operative doctrines themselves overlap. Necessarily also this court's resolution of the tendered issues will overlap.

A. *WWCR AS AN INFRINGEMENT ON THE FOREIGN AFFAIRS POWER*

As a general rule, there is no doubt (nor any disagreement between the parties) that in the area of Foreign Commerce, the power of the Federal Government is exclusive. Any infringement upon that power by state legislation is prohibited constitutionally (*Zschernig v. Miller* (1968) 389 U.S. 429; *Bethlehem Steel Corp. v. Bd. of Comm'rs* (1969) 276 CA 221).

Plaintiffs proceed to assert that the WWCR tax method of California *implicates* foreign commerce. There is no doubt that it does, but does it do so in the *Container* sense (463 U.S. at 194), i.e., implicate rather than resonate? From the evidence presented to this court, I conclude that WWCR, as applied to foreign multinationals, implicates foreign commerce within the meaning of *Container*.

Historically, although there has existed for many years the unitary method of taxation by California, it never was seriously a factor in foreign affairs until "the early 1970's"[4] when California first applied it to foreign multi-national corporations. Thus, we cannot measure American or foreign governmental reaction to its international use by events prior to 1972, including the negotiations and ratifications of foreign Tax Treaties. Moreover, we cannot realistically determine such reaction until the FTB's expanded application had time to be felt by taxpayers, through FTB audits and assessments, protests, negotiations between foreign nations and the United States, etc. Thus, the multitude of Tax Treaties entered into and ratified prior to 1978, which tacitly permit state taxation of foreign businesses (subject, of course, to

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[4]To achieve some degree of precision I find the specific year to be 1972.

the four *Complete Auto* test for interstate commerce) are of no value to us here, as they were in *Wardair*. A given topic cannot have a realistic impact on foreign affairs until it arrives on the scene.

The interplay of the executive and legislative role in Foreign Affairs must here be given attention. They both act in the Foreign Commerce and Foreign Affairs area, with Congress in ultimate charge, either by treaty ratification or by direct legislation (see *United States v. Curtiss-Wright Export Corp.* (1936) 299 U.S. 304); *United States v. Pink* (1942) 315 U.S. 429). A federal policy is formulated by either branch, and it will not be presumed that they are at variance, although from time to time, variance doubtless exists. No such variance can be found here from the Senate's failure to ratify the 1975 UK-US treaty in its entirety. In 1975, in direct response to California's extension of WWCR to foreign, including British, multi-nationals, Clause 9 (4) was inserted into the new UK-US Tax Treaty (signed on December 1, 1975) which for the first time in tax treaty history, would have proscribed the tax as levied here. The Treaty reached the Senate in 1978. In the Senate Foreign Relations Committee, Senator Frank Church (of Idaho, one of the State's then taxing by the unitary method) introduced a "reservation" to 9(4); it was defeated 10 to 5. On the Senate floor, the reservation again was defeated 44 to 34. The treaty as signed then received a vote of 49 to 32, five votes short of the ⅔ needed. Thereafter 9(4) was reserved without a vote and the treaty was ratified with the reservation. It was later approved by the British Parliament, but only after strong assurances by our Executive that the matter would be yet resolved (as indeed it partly was; inter alia, by California's 1976 legislation allowing a Water's Edge method effective 1/1/88) to eliminate WWCR with reference to UK multinationals. Am I to conclude from that a Congressional "foreign policy" *favoring* WWCR income taxation of foreign multinationals by individual states? No. Not in the face of three majority votes (one in committee and two on the floor) favoring

discontinuance of the practice.[5] If it shows anything at all, it is a Congressional preference, not rising to the dignity of a policy, favoring the elimination of WWCR in a foreign multinational context. Meantime the evidence shows unequivocally that the Executive branch all along, under three administrations since the WWCR problem in the present context became known, has steadfastly adhered to a policy of use of the arms length/separate accounting (AL/SA) method and not WWCR, both as to the States and the Federal Government.

FTB may argue somewhat logically that the negotiation, execution, and ratification of numerous tax treaties without 9(4) since 1978, with consequent knowledge of the Senate's action, shows a policy favoring whatever method, including WWCR, a state wishes to use. Indeed there is some prima facia support in *Wardair* for this position. But what was lacking in *Wardair* was (1) the consistent and continual Executive expression of policy and (2) the actual 1978 Senatorial episode, the only time Congress (or at least one-half of it) actually focused on WWCR in the international context. The Executive's foreign policy can only be what the Executive says it is, by official communication to foreign nations, by similar communication to the states and to Congress, by Amicus briefs, etc. (that is why none of this is hearsay). In one respect only has the Executive arguably varied from its policy, when it withdrew support for pending legislation in the Congress; but that is nothing more than a preference of methodology to achieve its policy, not a change of it. The Congressional foreign policy likewise can only be what Congress says it is. But what the Congress says, it says by affirmative legislation, or secondly by rejection of proposed legislation or to some extent by Senate action on Treaties; or possibly by implica-

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[5]This ruling is not inconsistent with *Container's* reference to the Senate vote in support of its rejection of the claim made there. I note no analysis of the Senate action by the Supreme Court; more important the *Container* Court used this as an example of *no* congressional policy, not as establishing affirmatively a policy for or against.

tion from Congressional enactments. But Congress cannot otherwise have an "intent", being the collegial body that it is.[6]

There is an international standard of accounting universally practiced by all nations of the world, including the United States, the AL/SA method. It is used to determine income of business entities derived from operations in countries other than their own, for purposes of income taxation by those countries. It operates on the assumption that only the income actually earned within a foreign country should be taxed by it (no double taxation), but because that cannot always be determined with exactitude, AL/SA uses formulary allocations when and as needed. But it is undisputed that its aim is to determine as closely as possible what actual income is derived from activities within the geographical boundaries of the taxing nation, and tax that income only. It has many flaws and imperfections, and some double taxation occurs under it, as so capably testified to by Professor Jon Bischel, but it is there as an ideal and as a working methodology. No other system is used internationally.[7] The numerous United States tax treaties however, all of which embody AL/SA, apply it to the income tax of the nations themselves and are silent with reference to taxation methods of their political subdivisions.[8]

WWCR on the other hand is a creature of California's FTB, and has been employed by other States of the United States as well, in assessing state income taxes on interstate and foreign businesses. It differs markedly from AL/SA in that at the very outset it brings into its calculation all income of the California business taxpayer, from wherever derived. Then it allocates to California its share of that income for income tax purposes by

[6]There is not to be found here, or in any other case to my knowledge, an Amicus brief by the Congress. Such a brief is of course impossible.

[7]There is an indication in the record that WWCR is used optionally by France and Canada where appropriate to prevent double taxation (RT Page 1900 et seq.)

[8]The Advisory Commission on Intergovernmental Relations recommended both ways to the Congress, for and against legislation prohibiting WWCR (Exhibits 50B (1982) and 50 (1981)).

using a three part formula, property, payroll and revenue within this State, over total property, payroll and revenue respectively, the average of which yields the fraction for allocation purposes. This method has been upheld in the interstate context, and in *Container* in the international context where the taxpayer was a United States corporate entity with foreign operations through foreign subsidiaries (whose income was included under WWCR). In this case we have a foreign (U.K.) parent (Barclays Bank, Ltd. (BBL)) of its two taxable subsidiaries, BBI and BARCAL, contributing its own income and that of its over 200 foreign subsidiaries into the formula for income taxation of BARCAL and BBI. Does this taxing scheme as so applied implicate foreign affairs? Because the tax impact falls on BBL, the foreign parent, rather than on a domestic parent as in *Container*, I conclude it does.

The evidence establishes that the AL/SA concept is universally used and favored while WWCR is everywhere disliked except as to some States of the United States. It is this foreign view of WWCR as here applied[9] that causes it to implicate foreign commerce. It is of no moment that such a view might be erroneous or even that WWCR might be a better and more efficient method academically; what matters is the international perception of WWCR as an arbitrary, unfair, and predatory measure of income taxation. The evidence shows that it is so perceived. The very fact that at the outset of WWCR's application California reaches out beyond American territorial borders to include income of Foreign Corporations wholly uninvolved with California, generates a spontaneous conclusion that foreign commerce is being taxed. The first and very prompt adverse reaction to it was vigorous and immediately successful, the insertion of 9(4) into the 1975 UK-US treaty, negotiated and executed by the Executive. The next reactions were after the reservation of 9(4) in the Senate ratification. A 1979 trip to Washington by Michael John Grylls, Member of Parliament, was made to request relief from federal officials. By 1980, the Demarches from the European

[9]Henceforth, unless otherwise noted, the abbreviation "WWCR" shall mean the method as applied in this case, i.e., a foreign parent case.

Economic Community started to arrive. They, along with other forms of diplomatic communication, showered the Executive with protests over California's WWCR and its departure from the international standard. The British Prime Minister spoke directly to the President about it. The President on October 26, 1983 established the "Working Group" to work on and suggest means of solution of this international problem — the Group reported in 1984, recommending inter-alia an end to WWCR. The UK in its Finance Act of 1985, enacted but did not implement a form of retaliation which had some effect on dividend policies of American companies operating in Britain. Finally, California went to a Water's Edge solution (Exhibit 55), thereby alleviating much of the international outcry. Disruption and embarrassment to the federal government necessarily resulted.

B. *THE SUPREMACY CLAUSE (PRE-EMPTION)*

There is no pre-emption here, not in the sense in which Plaintiffs assert it. The *Hines v. Davidowitz* (1941) 312 U.S. 52, 62 type of pre-emption specifically referred to by Plaintiffs (POB Page 42-43) exists in circumstances in which the nature of the State action affecting foreign affairs is so much in obvious conflict with the Constitution's insistence on federal involvement only, that the Constitution in and of itself has "pre-empted" the action. After so stating the rule, Plaintiffs go on to argue its existence by referring to the federal position on AL/SA and to claimed Congressional pre-emptive action (POB Page 43-50).

As heretofore indicated, I find no Congressional expression either way on this subject. Moreover that issue is disposed of by the *Container* case, for it found no Congressional expression of policy inconsistent with WWCR; nor did it find any such policy consistent with it. As to what might be termed "inherent pre-emption" of the *Davidowitz* or *Bethelem Steel* style, I find it present *in the specific context of this case*, a foreign multinational parent whose local subsidiary is taxed by WWCR. Discussion on this point will however be deferred to the next heading where it more appropriately belongs. It is my firm belief that the second of the two additional *Japan Line* tests for commerce (need for federal uniformity) is the equivalent of inherent pre-emption. The

latter also includes the so-called "Dormant Commerce Clause" analysis.

C. *WWCR'S BURDEN ON FOREIGN COMMERCE*

The second of the two additional *Japan Line* tests forbids a state tax on instrumentalities of foreign commerce, which as above stated includes by analogy, and applies to, corporations. I conclude from the evidence before me that in this case, in which the burden of the state tax falls ultimately upon a foreign parent of the taxed subsidiary, federal uniformity is essential. If California may permissibly impose this burden, so may every other state where business is conducted; and with variations, such that international chaos in the form of confusion, dissension, offensiveness, embarrassment, and retaliation are likely to result.

This case factually demonstrates as extreme an example of predictable international consequences stemming from a local tax as can be conceived. BBL, the UK corporate parent, in 1977 owned over 220 subsidiaries (including subsidiaries of subsidiaries) throughout the world, of which two only were incorporated in the United States (Barclays Bank of New York [BBNY] and BARCAL). One other only, BBI, a UK company, also did business in the United States. BARCAL was a subsidiary of BBI, along with BBNY and over 70 others operating in some 34 nations and territories outside the UK. BBL operated in some 60 nations, including those in which BBI and its subsidiaries operated. The percentage of total unitary income of the Barclays corporate network attributed by the FTB to California (both BARCAL and BBI) for 1977 was less than one and one-half (1.5%). Yet the 98.5% of the Barclay's Group income having its source outside the United States (except for the insignificant, relatively speaking, income of BBNY — See Exhibit 52R) was included in the pot from which California's 1977 income tax was to be measured, and thereby raised the tax by $154,098.00. We may say what we will about how it tends to average out over the years, how it is a relatively inconsequential sum in the overall Barclay's financial scheme, how it is no worse in actuality than AL/SA, and the like; but we cannot avoid a justifiable reaction by BBL, steeped as it is in the AL/SA tradition, of outrage. The

ensuing similar reaction of the UK, one of America's closest trading partners, is not only understandable but highly empathetic. Diplomatic consequences in the form of protests, negotiations, treaties, Executive and Congressional activities, retaliatory legislation, etc. followed, all but the last joined in by a multitude of other foreign trading partners. The record is full of examples of how the income taxation method of one state (California) has caused an inordinate amount of international furor. This is an area in which the federal government should be speaking with one voice; its foreign affairs are "implicated" by California's WWCR.

Let me stress that while we have empirical evidence of adverse international reaction, none was needed for the one voice principle to apply. Given the background up to 1977 of AL/SA and the custom of nations, given the nature of WWCR, given the addition to *Container's* factual setting of the fact that the tax burden falls on a foreign multiple parent corporation, the impact on foreign affairs was inevitable. And it was sufficiently unique and substantial to require uniformity of action in dealing with it.

FTB argues that the foreign brou-ha-ha was contrived, orchestrated by the UK alone so as to bring before this court the very evidence presented at the trial, including a disingenuous piece of "retaliatory" legislation that does not retaliate. We are of course aware that British lawyers can read and interpret *Japan Line*, *Container*, and any other Supreme Court case as well as we; and action can be taken accordingly. So without accepting the metaphors, I can accept the obvious fact that Britain took the lead in initiating the outcry and causing others to join in it (the EEC for example). But how else is foreign reaction generated? Someone must begin the outcry, and inevitably and understandably will cause others to join in it. The foreign reaction was and is no less genuine because Britain brought it about. As to the British legislation, it is indeed retaliatory if effectuated by "laying an order" in the British parliament, which has not yet been done. But such retaliation was not at all beyond possibility and likelihood up to 1986, when California went to Water's Edge. In that regard I am mindful of our own government's recent imposition of tariffs on certain Japanese imports, after endless frustrating efforts to obtain from Japan voluntary alleviation of what we perceived as

unfair Japanese trade practices. That action was very real, and against one of our closest trading partners, much like Britain. There was no frivolity associated with Clause 27 of the 1985 Finance Act.

In dealing with the federal uniformity test, *Container* posited the judicial lack of competence "to determine precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please. The best we can do . . . is to attempt to develop objective standards that reflect very general observations about the imperatives of international trade and international relations." (463 U.S. at 194). One difference here is that we do have considerable evidence, which the *Container* Court did not have, of actually offended foreign nations and why WWCR offends them, enough to compel a finding of such offense. But in addition I have developed an objective standard about the imperatives of international trade and relations. That standard is that where a foreign multinational's non-domestic income is included in a formula for attribution of income taxable by a State of the United States in which that entity does business through a branch or subsidiary, given the custom of nations as to AL/SA, foreign nations will be offended, our federal government will be assailed by foreign protests, the possibility of justifiable retaliation is very real, and a need for federal uniformity exists.

* * *

The first of the two additional requirements to sustain a tax on foreign instrumentalities of commerce is "the enhanced risk of double taxation". The emphasis of this test is not on foreign reaction so much as on the more elusive and academic question of double or multiple tax.

There is a definite risk of, as well as actual double taxation here, but it is not inevitable as required by *Container*. While it plays a role in my ruling regarding federal uniformity, the *Container* holding prevents its application to the first test. All the same aspects of double taxation involved here were involved in

Container, although I agree with Plaintiffs that in this foreign multi-national context they are more aggravated. But all of them were essentially considered and rejected in *Container* (463 U.S. at 189-193). The only one that gives me pause is the automatic "asymmetry" which I find exists here but did not exist in *Container* (a domestic corporation using foreign subsidiaries to do business in foreign countries is not subject to WWCR); but I note that *Container* discusses it under the rubric of the second test, federal uniformity in foreign affairs (463 U.S. at 194-195), as does *Japan Line*, (441 U.S. at 452-453). Under that test, automatic asymmetry is one of the by-products of WWCR upon which I relied in finding WWCR unconstitutional as here applied.[10] But the automatic asymmetry factor is not a consideration in the multiple taxation test. I am bound to follow Supreme Court precedent. To keep faith with *Container's* precedent I conclude that WWCR passes the first test.

D. *WWCR'S ALLEGED DISCRIMINATION AGAINST FOREIGN COMMERCE*

There is defacto discrimination against Foreign Commerce in the context of this case. I find credible the evidence which shows that a foreign based multi-national does not have readily available to it the necessary financial accountings from many of its foreign subsidiaries to enable it to comply with WWCR's requirements and concurrently take advantage of certain benefits available under California tax law. Tax accounting and financial accounting are admittedly different; one does not and should not normally use the accounting appropriate to an annual shareholder's report to prepare and file an income tax return, in California or elsewhere. There are United States GAAP (Generally Accepted Accounting Principles), United Kingdom GAAP, and other systems, varying to greater or lesser degrees from nation to nation. There are developed nations and developing nations, with different needs and different accounting methods and procedures. Books of foreign subsidiaries of BBL (and BBI) are kept in accordance with accounting procedures in the country of incorporation or in which they do business. The Internal Revenue Laws and Regulations of the federal government contain specific rules affecting income taxation of foreign multi-nationals, but they include only income whose source is within the territorial borders of the fifty states, and such income is determined under AL/SA; thus the income of foreign subsidiaries is ignored. Foreign parent corporations which do business in California must under WWCR report to FTB the income of their subsidiaries. But that income as reported to the parent sans WWCR is reported and accepted as prepared by and for each subsidiary. Nothing further by way of adjustment or information is needed nor is appropriate for the parent from those foreign subsidiaries to enable the parent to file tax returns in its own country and with the IRS. But when it becomes necessary for the foreign parent to report its foreign subsidiary's income to the taxable entity for inclusion in WWCR, the readily available financial information does not fit. There are adjustments that must be made (e.g., translation of currency, adjustment of fixed assets, leased assets and bad debts, conversion to GAAP, etc.) and others that can and properly should be made to take advantage of FTB's authorized deductions and other benefits[11] (e.g. depreciation allowances). Such information is not maintained on a current basis by those foreign subsidiaries and hence is not readily available and sometimes is totally unavailable. FTB's experts agree that literal compliance with WWCR is impossible, because no foreign multi-national maintains appropriate accounting books for it. The sole reason for changing accounting methodology to make it regularly available is to file properly under WWCR. The cost to reconstruct such information for past years is prohibitive; the cost to set up and maintain a system to obtain it currently by changing the accounting methodology in each appropriate foreign subsidiary is huge, over $5,000,000.00 to establish and over $2,000,000.00 annually to maintain. Such amounts are

[10] It is not feasible for me in this Intended Decision to refer to every specific item of evidence which supports a finding or conclusion. Many Exhibits and much testimony not specifically enumerated support the various parts of this determination.

[11] There is no point in turning this into an accounting nightmare by further enumeration of the accounting changes and potential changes involved. But they are there.

conceded by FTB to be unreasonable if true; but they are claimed unnecessary for proper compliance. I find them so necessary.

Plaintiffs claim that this amounts to discrimination against foreign commerce because only a foreign multi-national is put in this position of either foregoing available tax reporting benefits (including the use of approximations — see infra) or spending inordinate sums to be in a position to file properly; or of course to discontinue business in California. Correlatively, competitive businesses not conducting business in other nations, including domestic parent corporations with foreign subsidiaries,[12] do not have this added burden, and hence are given an advantage by FTB. This is assertedly "economic protectionism". The claim is valid; there is a less intrusive and less burdensome alternative, Water's Edge; WWCR does unfairly and systematically discriminate against foreign multi-nationals and thereby unduly burdens foreign commerce. (*Boston Stock Exch. v. State Tax Comm'n* (1977) 429 U.S. 318; *Hunt v. Wash. State Apple Advertising Comm'n* (1977) 432 U.S. 333; *H. P. Hood & Sons v. Dumond* (1949) 336 U.S. 525.)

FTB counters this claim first by maintaining that dollar cost of compliance as presented by two Plaintiff witnesses is not credible; I have more than allowed for possible exaggeration, even though FTB presented essentially no evidence on the point. FTB's second defense is grounded on Cal. Adm. Code, Title 18, Section 25137-6, pursuant to which it claims there are alternatives to strict compliance with WWCR requirements. The regulation does specify that no adjustment to income is required unless it is material. It also allows use of reasonable approximations, considering the expense and effort required to obtain the necessary information for compliance. It also allows for advance determinations of what the taxpayer proposes to do. All these are illusory to the taxpayer, for neither binds the FTB to accept anything; it has

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[12]Though domestic parents of foreign subsidiaries (See *Container*) have this same dilemma as to their foreign operations, they do not have it as a result of WWCR. They have it because federal income tax laws require it. Those same laws do not require it as to foreign subsidiaries of foreign parents.

the complete authority to make the ultimate decision as to whether an item is material, as to whether or not an approximation is reasonable and will be accepted, and whether an advance determination will be made and in what way. There is no genuine alleviation of the taxpayer's problem by these techniques. There are certain situations in any type of taxing case and with any taxing authority, in which approximations must be resorted to. But taxation by approximation to avoid an unduly onerous dollar cost of compliance burden is not a cure.

E. WWCR AS VIOLATIVE OF DUE PROCESS

Plaintiffs claim that because an element of the WWCR calls for materiality, reasonable approximations, and advance determinations, all at the unfettered discretion of FTB, with no guidelines, there is a violation of the due process clauses (both U.S. and California) insofar as the tax relates to a foreign multinational.

The WWCR regulation is not on its face uncertain, nor does the approximation segment make it uncertain. Its taxing rules are sufficiently clear and understandable to satisfy due process. The discretionary advance determination, reasonable approximation, and materiality rules (materiality does not really belong in this thought —it is inherent and essential in every tax scheme) are only there to the extent a taxpayer seeks to avail himself of them. They are not imposed willy-nilly.

What does constitute a due process violation is the fact that all witnesses agreed that with customarily and currently available accounting data, literal compliance with WWCR requirements is impossible for foreign multi-nationals such as Plaintiffs, and the only way to "comply" is by supplication and negotiation (absent an unduly burdensome cost of compliance). There is no reasonable certainty and no judicial reason to believe that whatever the taxpayer considers reasonable or material will be so treated by the FTB. I certainly would not expect this type of pre-established capitulation from the fine and dedicated public servants (Ben Miller, Eric Coffill, Stephen Wetzel, etc.) whose efforts in the

State's behalf came to my attention at the trial. Bureaucratic mistakes and excesses are always possible.[13]

Thus I conclude that WWCR as applied to Plaintiffs violates due process, both federal and state. (*C.F. Chy Lung v. Freeman* (1876) 92 U.S. 275; *Grayned v. Rockford* (1972) 408 U.S. 104; *McDonnell Douglas Corp. v. Franchise Tax Bd.* (1968) 69 C2 506).

F. PLAINTIFFS' BURDEN OF PROOF

FTB claims that Plaintiffs have a burden to establish not only that the amount of tax assessed was improper but what the proper amount should be, citing *People v. Schwartz* (1947) 31 Cal. 2d. 59. I have no quarrel with the rule, but it does not apply here. Since the WWCR method has been found invalid, the additional assessment imposed because of it was improper; correlatively the amount originally paid is the correct amount, any excess over that having resulted from the invalid method. As to the dollar amount to be refunded by FTB, including interest, the parties have stipulated to calculate and insert that amount in the judgment (Exhibit 1, Page 2).

G. CONGRESSIONAL ACTION PREVAILS OVER INCONSISTENT EXECUTIVE ACTION IN FOREIGN RELATIONS[14]

This issue has been resolved favorably to FTB (See Section IV A, supra).

H. EFFECT OF CONTAINER AND WARDAIR

FTB has relied heavily on its interpretation of these two cases. If indeed they were to be so interpreted, the judicial result would

[13]As where the FTB auditor here failed for arbitrary reasons to deduct from plaintiffs' total income (working off an annual report for lack of better information) that attributable to "associate" (less than 50% owned) companies of BBL.

[14]FTB's jurisdictional argument (DB Page 6-7) has been disposed of under Section II.

have been in FTB's favor. In the course of resolution of Plaintiffs issues as tendered I have resolved FTB's contentions partly in FTB's favor and partly otherwise.

Container did conclude that the "four usual issues" involved in state taxation of both interstate and foreign commerce resolved themselves in FTB's favor (DB Page 17-21). *Container* determined there was no expressed Congressional policy *against* WWCR, but did not address the question of whether such policy was expressed Congressionally *for* it. (DB Page 21-22). The issue was certainly there for *Container* to address, and had such policy been so found it would have ended the inquiry and avoided the need to address the two additional *Japan Line* factors. The failure to deal with that issue has led me to interpret *Container* as indicating judicially no Congressional policy either way.

Proceeding to the first additional *Japan Line* test, in its Dormant Foreign Commerce Clause analysis *Container* resolved it in favor of FTB. I respected that precedent and have followed it. *Container* did likewise regarding the second test, but it was necessarily limited to a domestic parent case, and I have found enough constitutionally significant differences in this foreign parent case to determine WWCR invalid as here applied. The great disagreement of FTB comes from its interpretation of the *Wardair* holding (DB Page 23-43) to the effect that Congressional "acquiescence" can and will establish a foreign policy. Citing five indications of such acquiescence both Executively and Congressionally (Income Tax Treaties, U.S. Model Convention and Reservations to OECD and UN Model Conventions, FCN Treaties, Senate Action Regarding 9(4), and no enactment of proposed legislation to prohibit WWCR), FTB maintains that *Wardair* compels a finding of policy by acquiescence here. Each factor was carefully considered, and I found no sufficient similarity to *Wardair* to suggest its application. *Wardair* involved an uninterrupted string of Treaties, Conventions, and legislation, before and after the tax year, with no specific disagreement or dispute either by Congress or the Executive (except for an amicus brief). Here we have no manifestation of the problem until 1972, followed by a prompt expression of Executive policy opposing state WWCR in 1975 (the Treaty), echoed by the Senate in its

actual vote count in 1978, followed by nothing of consequence thereafter from Congress and uninterrupted perseverance in its policy by the Executive. The U.S. Model Convention, like the tax treaties since 1978, does not impress me as indicative of a policy (See IV A, supra); "reservations" are just that, reservations of opinion and not themselves opinion or policy; a failure on the part of Congress to vote on a pending bill expresses nothing by way of intent and I have no evidence that Congress actively voted to defeat proposed legislation outlawing WWCR. With every respect for FTB's *Wardair* argument and the competent manner in which it was presented, I disagree.

Bass, Ratcliff & Gretton, etc. v. State Tax Comm. (1924) 266 U.S. 271, involving a unitary form of tax on foreign commerce is contended by FTB to have been confirmed by *Container* (DB Page 17, FN 10) and to be persuasive here. I cannot agree. If *Bass, Ratcliff* were considered authority for the broad proposition that WWCR is constitutionally proper as to foreign multi-nationals, *Container* would simply have cited it for that proposition and it would have ended the Court's inquiry. Instead, after citing it, the *Container* court twice expressly reserved this very question, thereby making it clear that *Bass, Ratcliff* is not precedent for FTB's contention here.

I. DORMANT FOREIGN POLICY ANALYSIS

This issue has been addressed. No double taxation proscription was found, following the precedent of *Container*, but the need for federal uniformity was found. FTB's arguments on double tax (DB Page 46-60) have been accepted or are academic. FTB's arguments on federal uniformity (DB Page 60-72) have been considered (IV A and IV C, supra), and found unpersuasive.

J. COSTS OF COMPLIANCE

FTB presents its position with reference to the legal and constitutional effect of Plaintiffs' evidence of their costs of compliance with California's WWCR regulation at DB Page 73-97. All of it has been considered and dealt with in connection with IV D, supra. There are several points made by FTB however regarding which some comment is appropriate.

FTB claims of course that Plaintiffs' alleged costs of compliance are exaggerated and not genuinely necessary. An example is given of the fact that BBI actually did undertake to file for 1977 (and prior years) on a WWCR basis, and it has many foreign subsidiaries whose income was included in the return, prepared at a very nominal charge by Price Waterhouse (DB Page 77-79). I find this unpersuasive. The return was not prepared in accordance with Regulation 25137-6, and for this reason it was rejected by FTB (along with prior similar returns). It was erroneous in that it used figures from the annual report, admittedly inaccurate for income tax purposes. Furthermore, the fact that a taxpayer complies or attempts to comply with a tax scheme he considers invalid does not prevent him from presenting fully his reasons for its claimed invalidity in later protests. I am aware of no estoppel principle that applies here. And while I have understood the point of this FTB argument I find it without merit.

FTB suggests that Plaintiffs' costs of compliance evidence is not worthy of belief because no money has yet been spent by Plaintiffs to comply (DB Page 84). This begs the question. It would be folly for a taxpayer who claims a given tax is invalid to spend millions to comply with it when he is concurrently challenging it formally by lawsuit.

Finally in response to Plaintiffs' claim that WWCR offends American policy of encouraging foreign businesses to invest in this country, FTB points to continuing success and prosperity of Plaintiffs in California (DB Page 96). FTB misapprehends the policy. The fact that a certain business is successful does not negate the propriety of its efforts to defeat actions perceived to be harmful to the policy. The policy does not encourage foreign investment just to a certain profitable point; it encourages it to a point of continuing and ever increasing profitability.

K. DUE PROCESS

No further discussion is appropriate.

L. IMPOSITION OF WATER'S EDGE

FTB's position has merit. Plaintiffs assert (POB Page 111-113) that this court should impose upon FTB the AL/SA method. This court can only act negatively, to find the WWCR method invalid as applied to Plaintiffs and other similarly situated; it cannot legislate. In their closing brief (PCB Page 81), Plaintiffs appear to retreat from this effort. In any event, the suggestion is rejected.

V

CONCLUSION

The tax as sought to be imposed here by FTB is unconstitutional. The claim for refund will be allowed.

Unless a specific request is filed by either party as in CCP Section 632 provided, this Intended Decision shall be deemed in full compliance with that Section's requirement for a Statement of Decision.

DATED: JUNE 12, 1987

GEORGE E. PARAS
George E. Paras
Judge of the Superior Court, Pro Tem

EXHIBIT 1

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LTD.,
a corporation of the Country of England,

Plaintiff,

vs.

FRANCHISE TAX BOARD,
an agency of the State of California

Defendant.

BARCLAYS BANK OF CALIFORNIA
a California Corporation,

Plaintiff,

vs.

FRANCHISE TAX BOARD,
an agency of the State of California,

Defendant.

No. 32509 & No. 325061 (Consolidated for Purposes of Trial)

ENDORSED: November 3, 1986
JOYCE RUSSELL SMITH, CLERK
By Kathleen L. Burgess, Deputy

SCHEDULE I

JOINT STIPULATION OF FACTS
Trial Date 11-10-86

IT IS HEREBY STIPULATED by and between the parties, through their attorneys of record, that the following facts are agreed and undisputed. This stipulation shall not be construed as a concession by either party of the relevancy or materiality of any of the facts stipulated, and the parties reserve the right to argue the relevance, materiality or weight of any of the facts stipulated.

All documents referred to herein or specifically enumerated are compiled under separate cover, have been reviewed by counsel for the parties and their authenticity and foundational basis admitted. The documents shall be entered into evidence. Nothing contained in this stipulation shall prevent a party from introducing at trial any other or further evidence. With permission of Court, documents described in paragraphs 32, 40, and 41 hereof will be deemed admitted in evidence in entirety without physically presenting the same at trial. Either party may refer to said documents in summary form or as individual exhibits at trial or on appeal as evidence admitted at trial.

Nothing contained herein shall be construed as a waiver by any party of its right to review on appeal any question of law or fact arising in this action in the same manner and to the same extent as if the facts set forth herein had been proven in open court.

The parties will make any computations necessary for inclusion in appropriate findings after the court's decision in this matter.

This stipulation shall only apply to the above-entitled consolidated actions and to any appeals from the judgment of this Court.

FACTS

The following facts are agreed and undisputed:

1. During income year ending September 30, 1977 (hereafter referred to as income year 1977), plaintiff Barclays Bank International Limited ("BBI") was a corporation organized and existing under the laws of England and was qualified to do, and was doing, business as a banking agency in San Francisco, California.

2. During income year 1977, BBI was engaged in general retail and commercial banking, leasing, and consumer and commercial finance, directly or through subsidiaries, in approximately fifty-five (55) countries and territories.

3. During income year 1977, BBI itself operated through banking agencies or branches in approximately thirty-three (33) nations or territories outside the United Kingdom. BBI operated in the United States through branches or agencies located in the states of Georgia, Massachusetts, Illinois, New York and California.

4. During income year 1977, BBI owned more than fifty percent (50%) of over seventy (70) subsidiaries which operated in approximately thirty-four (34) nations or territories outside the United Kingdom.

5. During income year 1977, BBI owned banking subsidiaries which were organized and operated in the United States, including Barclays Bank of New York ("BBNY") and Barclays Bank of California ("Barcal").

6. During income year 1977, BBI was a wholly-owned subsidiary of Barclays Bank Limited ("BBL"), a United Kingdom clearing bank, organized and existing under the laws of England.

7. During the income year 1977, BBL owned, directly or indirectly, in addition to BBI and its subsidiaries, over one hundred forty (140) subsidiaries, none of which was incorporated under the laws of the United States or any political subdivision or territory thereof, and none of which operated in California or in the United States.

8. During the income year 1977, BBL and all subsidiaries of which it owned more than fifty percent (50%) of the stock, directly or indirectly, including BBI and Barcal, operated in over sixty countries or territories. A list of these subsidiaries showing country of incorporation and equity ownership is attached as trial Exhibit 8. BBL and such subsidiaries will be referred to as the Barclays Group and individually or collectively as a member or members of the Barclays Group, respectively.

9. During income year 1977, Barcal, a California banking corporation and a wholly-owned subsidiary of BBI, was engaged in the commercial banking business in the State of California where it operated through forty-nine (49) branch banking offices.

10. On January 1, 1985, pursuant to the United Kingdom's Companies Act and the Barclays Bank Act 1984, BBL was merged with BBI under the name Barclays Bank PLC, and a holding company, Barclays PLC, became the parent of Barclays Bank PLC.

11. Defendant Franchise Tax Board ("FTB") is an agency of the State of California. The FTB is vested with the power and duty to administer the Bank and Corporation Franchise Tax Law of the State of California.

12. For the income year 1977, BBI prepared and filed a California Bank and Financial Tax Return and paid a total tax liability to the Franchise Tax Board of $14,447.54.

13. For the income year 1977, Barcal prepared and filed a California Bank and Financial Tax Return and paid a total tax liability to the FTB of $541,276.49.

14. The FTB conducted an audit of the California tax returns of BBI and Barcal for the income year 1977. Upon audit the FTB determined that BBI and Barcal were part of a worldwide unitary business conducted by all members of the Barclays Group.

15. Based upon its determination that BBI and Barcal were a part of a worldwide unitary business conducted by all the members of the Barclays Group, the FTB issued Notices of Additional Tax Proposed to be Assessed (hereafter Notices) as follows: to BBI in the amount of $4,076.02 for a total tax for the income year of 1977 of $18,523.56; to Barcal in the amount of $254,699.45 for a total tax for the income year of 1977 of $795,975.94.

16. The FTB's calculation of BBI's and Barcal's California tax liability was set forth in Schedule 1 of the attachment to the Notices as follows:

BUSINESS INCOME:		
INCOME BEFORE TAXES, SECURITIES GAINS/LOSSES, MINORITY INTERESTS AND EXTRAORDINARY ITEMS	pg. 10 Pros.	£270,300,000
SECURITIES GAINS/(LOSSES)	pg. 30 Bbl A/R	(2,400,000)
EXTRAORDINARY ITEMS	pg. 23 Bbl A/R	300,000
TOTAL POUND STERLING		268,200,000
CONVERSION RATE		1.7025
BUSINESS INCOME — IN U.S. DOLLARS		$456,610,500

	BBI	Barcal
APPORTION TO CALIFORNIA	$149,083	$6,406,245
TAX RATE	.12425	.12425
TAX	$ 18,524	$ 795,976
TAX PREVIOUSLY ASSESSED	$ 14,448	$ 541,276
ADDITIONAL TAX	$ 4,076	$ 254,700

17. The reference to "page 10 PROS" is a reference to page 10 of the Preliminary Prospectus dated March 31, 1981 $125,000,000 Barclays North American Capital Corporation % Guaranteed Capital Notes due 2006. The references to pages 30 and 23 respectively were references to the BBL Reports and Accounts for 1977. The reference to "TAX PREVIOUSLY ASSESSED" means the tax paid by BBI and Barcal on filing, net of certain refunds.

18. BBI and Barcal filed protests of the proposed assessments in 1982, which protests were timely. BBI had originally filed its tax returns for the income year 1977 on the basis that it was part of a unitary business composed of itself and its subsidiaries. BBI protested the tax on the basis, *inter alia*, that the correct method upon which to compute its tax liability was separate entity/arm's length accounting.

19. Barcal timely filed a protest of the proposed assessment. It had originally filed its tax returns for the income year 1977 on a separate entity/arm's length accounting basis, and protested the

additional assessment on the basis, *inter alia*, that the correct method upon which to compute its tax was separate entity/arm's length accounting.

20. On May 21, 1984, BBI paid the additional proposed tax of $4,076.02 and BBI's administrative protest was converted by operation of law into a claim for refund of taxes. It is upon this claim that the instant litigation is based.

21. On October 31, 1983, Barcal paid additional proposed tax of $250,000.00 and Barcal's protest was converted by operation of law into a claim for refund of taxes. It is upon this claim that the instant litigation is based.

22. After the issuance by the FTB of the Notices and the filing by BBI and Barcal of the protest, the FTB adjusted the audit schedules as follows:

BUSINESS INCOME PER AUDIT	£268,200,000
LESS: INCOME OF ASSOCIATED COMPANIES	(39,700,000)
ADD: DIVIDENDS FROM ASSOCIATED COMPANIES	5,105,000
ANZ GROUP DIVIDEND	735,000
ADD: ACCOUNTING METHOD CHANGE (AMORTIZATION — FROM AGREEMENT PRIOR YRS)	1,429,000
ADD: EXTRAORDINARY INCOME, AMOUNT THAT HAD BEEN EXCLUDED (ATTRIBUTABLE TO MINORITY SHAREHOLDERS)	100,000
REVISED BUSINESS INCOME — POUND STERLING	£235,869,000
CONVERSION RATE	1.7025
REVISED BUSINESS INCOME — U.S. $	$401,566,973
REVISED APPORTIONMENT % — BBI	.0003232
INCOME APPORTIONED TO CALIFORNIA	129,786
TAX RATE	12.425%
TOTAL REVISED TAX	16,126
PREVIOUSLY ASSESSED	14,448
ADDITIONAL TAX — REVISED BBI	$ 1,678
REVISED APPORTIONMENT % — BARCAL	.0139032
INCOME APPORTIONED TO CALIFORNIA	5,583,066
TAX RATE	12.425%
TOTAL REVISED TAX	693,696
PREVIOUSLY ASSESSED	541,276
ADDITIONAL TAX — REVISED BARCAL	$ 152,420

23. Board issued Notices of Action on Taxpayer's Protest to BBI and Barcal on February 15, 1985, for the amounts set forth in paragraph 22.

24. The payment of $250,000.00 made by Barcal on October 31, 1983 was credited by the Board against Barcal's additional tax as revised of $152,419.01. The remaining amount was credited to the interest owing on such liability and on April 19, 1985 an additional payment of $25,670.82 with respect to the interest owing on the $152,419.01 tax was made and credited to Barcal's account. The total amount of refund being sought by Barcal in this case is tax in the amount of $152,419.01 and interest of $123,251.81.

25. Payment of $4,076.02 made by BBI on May 21, 1984 was credited against the revised tax of $1,678.46 and interest on such amounts of $1,505.06. The remaining amount of $892.50 was subsequently refunded to BBI with interest as provided by law. These additional payments of $1,678.46 of tax and $1,505.06 of interest are the amounts for which BBI is seeking a refund in this action.

26. The FTB, through its attorney Marvin J. Halpern ("Halpern"), and BBI and Barcal, through their attorney Joanne M. Garvey ("Garvey"), have corresponded regarding, *inter alia*, plaintiffs' respective Section 25137 petitions for the income years ending September 30, 1977, 1978 and 1979 and December 1, 1979. In addition members of the FTB or the FTB staff have drafted certain documents concerning Section 25137 petitions. These documents include:

26a. Letter from Garvey to Halpern dated May 18, 1984.

26b. Letter from H. Barry Berlin to California Franchise Tax Board, dated May 22, 1984.

26c. Photocopies of checks numbers 45007-45009 of BBI, dated May 21, 1984 drawn on Barclays Bank International Limited account payable to the Franchise Tax Board.

26d. Letter from Halpern to Garvey dated June 22, 1984.

26e. Letter from Garvey to Halpern dated June 28, 1984.

26f. Letter from Halpern to Garvey dated July 24, 1984.

26g. Letter from Garvey to Halpern dated September 11, 1984.

26h. Letter (via Telex) from Garvey to Halpern dated November 9, 1984.

26i. Letter from Halpern to Garvey dated January 28, 1985.

26j. FTB's Notice of Action on Taxpayer's Protest to Barcal, dated February 15, 1985.

26k. FTB's Notice of Action on Taxpayer's Protest to BBI, dated February 15, 1985.

26l. Letter from Garvey to Halpern, dated June 28, 1985.

26m. Letter from Halpern to Garvey dated January 8, 1986.

26n. Exhibit No. 3 to Marvin Halpern's deposition taken January 16-17, 1986, entitled "Statement of the Franchise Tax Board Pertaining to Section 25137 Petitions."

26o. Memorandum from Martin Huff to Walter Harvey, concerning "Petitions for Relief under Section 25137 Bank and Corporation Tax Law," dated June 23, 1977.

26p. Memorandum from Benjamin F. Miller to Martin Huff, Executive Officer, concerning "Meeting with Dennis Amundsun, Director Department for Economic and Business Development," dated March 21, 1978.

26q. Memorandum from Marvin J. Halpern to Glenn L. Rigby dated July 25, 1984.

26r. Letter from R.E. Gilbert to the California Franchise Tax Board, dated October 31, 1983.

27. For purposes of this litigation only, BBI and Barcal agree that for income year 1977 they were members of a worldwide unitary business within the meaning of Revenue and Taxation Code Section 25101, *et. seq.*, composed of the members of the Barclays Group.

28. On September 23, 1983, United States Secretary of Treasury, Donald T. Regan, announced the establishment of the Worldwide Unitary Taxation Working Group ("Working Group").

29. The Final Report of the Worldwide Unitary Taxation Working Group, Chairman's Report and Supplemental Views, August 1984, was transmitted to the President of the United States on August 31, 1984.

30. Among those testifying before, or submitting reports to, the Working Group or the Task Force of the Working Group were:

30a. Statement of the United Kingdom before the United States Treasury Working Group on Worldwide Unitary Taxation.

30b. Presentation by Mr. Barry Pollard, Inland Revenue, on United Kingdom Experience of Operating the Arms Length Principle With Special Reference to Transfer Pricing Enquiries.

30c. Statement of Canada before the United States Worldwide Unitary Taxation Working Group.

30d. Submission of the Australian Government to the U.S. Task Force on Unitary Taxation, dated January 4, 1984.

31. Trial Exhibit 31 to this stipulation is a true and accurate summary chart of the country of incorporation and the financial operating profit in pounds sterling of the members of the Barclays Group as set forth in the business records of the companies comprising the Group, prepared in the ordinary course of business and used, among other things, for the preparation of the Reports and Accounts of the Barclays Group.

32. Foreign governments, on their own behalf or as the representatives of official governmental bodies such as the European Economic Community (EEC), have sent communications (collectively trial Exhibit 32) to the United States government and to the several states of the United States, including California, expressing objections to use by the states, including California, of the worldwide combined reporting unitary method of state taxation. Some of these are:

32a. Letter from Hon. Nigel Lawson, Chancellor of the Exchequer for the United Kingdom to the United States Secretary of the Treasury, Hon. Donald T. Regan, dated July 12, 1983.

32b. Demarche from Italy, as President of the EEC, on behalf of the Nine European Economic Community Governments to the Department of State, Washington, D.C., dated March 19, 1980.

32c. Demarche No. 51 from the United Kingdom Embassy to the Department of State, Washington, D.C., dated March 25, 1980.

32d. Demarche No. 211 from the United Kingdom, as President of the EEC, on behalf of the Ten European Economic Community Governments to the Department of State, Washington, D.C., dated October 30, 1981.

32e. Demarche No. 692 from the Embassy of Canada to the Department of State, Washington, D.C., dated December 22, 1981.

32f. Demarche No. 83 from the United Kingdom Embassy to the Department of State, Washington, D.C., dated May 18, 1982.

32g. Demarche No. 283 from the Embassy of Canada to the Department of State, Washington, D.C., dated June 14, 1982.

32h. Demarche from the Government of Belgium as President of the EEC, on behalf of the ten European Economic Community Governments to the Department of State, Washington, D.C., dated June 29, 1982.

32i. Demarche from Greece, as President of the EEC, on behalf of the ten European Economic Community Governments to the Department of State, Washington, D.C., dated August 1, 1983.

32j. Demarche No. 481 from the Embassy of Canada to the Department of State, Washington, D.C., dated September 28, 1983.

32k. Demarche No. 383/83 from the Embassy of Australia to the Department of State, Washington, D.C., dated November 7, 1983.

32l. Demarche No. 461.20-LJ/hu from the Embassy of Switzerland to the Department of State, Washington, D.C., dated November 15, 1983.

32m. Demarche from the Federal Republic of Germany to the Department of State, Washington, D.C., dated November 28, 1983.

32n. Demarche No. EA-14533 from the Embassy of the Kingdom of the Netherlands to the Department of State, Washington, D.C., dated December 21, 1983.

32o. Demarche from the Embassy of Belgium on behalf of the ten European Economic Community Governments, the European Commission and the Embassies of Australia, Canada, Japan and Switzerland to the Department of State, Washington, D.C., dated January 25, 1984.

32p. Demarche from the Embassy of Belgium to the Department of State, Washington, D.C., dated January 25, 1984.

32q. Demarche No. 634 from the Embassy of Canada to the Department of State, Washington, D.C., dated February 27, 1984.

32r. Aide-memoire from the Government of Japan to the United States Government dated June 6, 1984.

32s. Official correspondence from the Hon. Marc Lalonde, Minister of Finance for Canada to the United States Secretary of the Treasury, Hon. Donald T. Regan, dated August 11, 1983.

32t. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, the Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. Robert Bangter, Governor of the State of Utah, dated February 15, 1985.

32u. Letter from J.L. Beaven, United Kingdom Consul-General to the United States, to the Hon. Willie L. Brown, Jr., Speaker of the California Assembly, dated June 18, 1984.

32v. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Honorable Richard D. Lamm, Governor of the State of Colorado, dated January 25, 1985.

32w. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, the Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. George A. Sinner, Governor of the State of North Dakota, dated March 18, 1985.

32x. Letter from Jacques S. Roy of the Embassy of Canada to the Hon. Robert Graham, Governor of the State of Florida, dated May 30, 1984.

32y. Letter from J. Raoul Schoumaker of the Embassy of Belgium and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. Robert Graham, Governor of the State of Florida, dated November 28, 1984.

32z. Letter from H.G. Walsh, Counsellor (Economic) British Embassy Washington, D.C. to the Honorable Edmund G. Brown, Governor of the State of California, dated October 30, 1981.

32aa. Letter from Christopher E. F. Davis, Consul Canadian Consulate, San Francisco, California to Gerald Goldberg, Executive Officer Franchise Tax Board of California, dated January 26, 1984.

32bb. Letter from J. L. Beaven, Her Majesty's Consul-General to the Honorable George Deukmejian, Governor of California, dated June 21, 1983.

32cc. Letter from the United Kingdom Chancellor of the Exchequer to the Secretary of the United States Treasury dated June 20, 1985.

32dd. Undated Memorandum from the Netherlands Government to the Governor of California.

32ee. Letter from the Hon. Pierre Trudeau to Hon. Ronald Reagan, President of the United States, dated September 24, 1983.

33. The following documents pertaining to treaties of Friendship, Commerce, and Navigation were provided to Benjamin F. Miller, Counsel for Multistate Tax Affairs for the FTB, by the Department of State:

33a. The first page and pages 15 and 16 of a Memorandum to the Embassy at Chungking for Use in Negotiating Treaty of Friendship, Commerce and Navigation. These pages, constituting the only pages received of the above-mentioned document by the FTB were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33b. The first page and pages 16 through 19 of a Memorandum to the American Embassy at Rio de Janeiro for Use in Negotiating Treaty of Friendship, Commerce and Navigation Between the United States and Brazil. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33c. The cover page and pages ii, 19, 20, 21, 202 and 203 of a preliminary draft of a study entitled *Standard Draft Treaty of Friendship, Commerce and Navigation* prepared under contract to the Department of State by Charles H. Sullivan. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to a letter dated August 22, 1980 and signed by Stuart E. Benson, Acting Assistant Legal Advisor, Office of the Legal Advisor, Department of State, addressed to D. R. Milton, Vice President Tax, Shell Oil Company, Houston, Texas, carbon copy to Benjamin F. Miller, Franchise Tax Board, State of California.

33d. Pages 13a through 15 of Annotated Draft FCN for Portugal prepared by Herman Walker. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33e. HICOG Bonn Despatch No. 2255 of February 17, 1954, pages 1 through 5 inclusive, with two page attachment No. 1868. These documents were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33f. A three page Airgram of the Department of State dated July 3, 1983 concerning FCN Treaty with the Netherlands, and replying to Embassy dispatch 1472. This document was an enclosure to a letter dated August 28, 1980, from Stuart E. Bensen, Acting Assistant, Legal Advisor, Office of the Legal Advisor, addressed to D.R. Milton, Vice President of Tax, Shell Oil Company, Houston, Texas, carbon copy to Benjamin F. Miller, Franchise Tax Board.

33g. Letter dated February 11, 1981 from Theodore W. Kassinger, Attorney Advisor, Office of Assistant Legal Advisor for Economic and Business Affairs, Department of State.

34. On July 9-10, 1985, the Parliament of the United Kingdom debated and unanimously passed legislation in Clause 27 of the Finance Act of 1985. The proceedings of Parliament are truly and accurately reported in the House of Commons Official Report, Parliamentary Debates (Hansard), Wednesday 10 July 1985, Volume 82, No. 152.

35. The United Kingdom's Finance Act of 1985.

36. There have been discussions and debates in, and documents presented to, the United States Congress concerning the use by the states of worldwide combined reporting, some of which are reported as follows:

36a. Statement of Senators Wilson and Mathias and Statement by the President of the United States in support of the Unitary Tax Repealer Act. 131 Cong. Rec. 17975-17978 (1985).

36b. Executive Session and Statement of Senator Hiyakawa regarding consideration of the United Kingdom-United States treaties. 125 Cong. Rec. 17427-17435, 17796 (1979).

36c. Executive session regarding consideration of tax convention with the United Kingdom. 124 Cong. Rec. 18402-18430 (1978).

36d. Executive session continued regarding consideration of tax convention with the United Kingdom. 124 Cong. Rec. 18651-18670, 18709-18712 and 19076-19078 (1978).

36e. Introduction of H.R. 3980 by Hon. John J. Duncan as reported in the Congressional Record of December 19, 1985 on pages E5754 and 5755 (extension of remarks).

37. Various committees of the United States Congress have held hearings on the issues of state taxation, including the use by the states of worldwide combined reporting, which committees' proceedings, some of which have been transcribed or which committees have issued reports, as follows:

37a. Committee on Ways and Means, 95th Congress, 1st Sess., Recommendations of the Task Force on Foreign Source Income (Comm. Print 1977).

37b. Senate Committee on Foreign Relations, Third Protocol to the 1975 Income Tax Convention With the United Kingdom of Great Britain, and Northern Ireland, as Amended, S. Doc. No. 5, 96th Congress, 1st Sess. (1979).

37c. Tax Treaties With the United Kingdom, the Republic of Korea, and the Republic of the Philippines, 1977: Hearings Before the Senate Committee on Foreign Relations, 96th Congress, 1st Sess. (1977).

37d. State Taxation of Foreign Source Income, 1980: Hearings on H.R. 5076 Before the House of Representatives Committee on Ways and Means, 86th Congress, 2d Sess. (1980).

37e. State Taxation of Interstate Commerce and Worldwide Corporate Income, 1980: Hearings on S. 983 and S. 1688 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance, 96th Congress, 2d Sess. (1980).

37f. Unitary Taxation, 1984: Hearings before the Subcomm. on International Economic Policy of the Senate Foreign Relations Comm., 98th Cong., 2d Sess. (1984).

37g. Interstate Taxation, S. 2173: Hearings before the Senate Committee on the Judiciary, 95th Cong., 1st and 2nd Sess. (1977-1978).

38. Various proposed Legislative bills have been introduced in the United States Congress that would, among other things, affect the states' use of worldwide combined reporting. Some of these bills are:

38a. H.R. 11798 (Willis) (1965)
38b. S. 916 (Ribicoff) (1969)
38c. S. 317 (Ribicoff) (1971)
38d. S. 4080 (Mathias) (1972)
38e. S. 2173 (Mathias) (1977)
38f. S. 1688 (Mathias) (1979)
38g. H.R. 5076 (Conable) (1979)
38h. H.R. 5903 (Satterfield) (1979)
38i. H.R. 8277 (Broyhill) (1980)
38j. H.R. 1983 (Conable) (1981)
38k. H.R. 6402 (Rodino) (1982)
38l. H.R. 2918 (Conable) (1983)
38m. H.R. 3243 (Frenzel) (1983)
38n. S. 1225 (Mathias) (1983)
38o. H.R. 4940 (Wyden) (1984)
38p. H.R. 6146 (Mica) (1984)
38q. S. 3061 (Hawkins) (1984)
38r. H.R. 3980 (Duncan) (1985)
38s. S. 1113 (Mathias) (1985)
38t. S. 1974 (Wilson) (1985)

39. The FTB and various committees of the California State Legislature have held hearings on California's use of world-wide combined reporting, some of which have been transcribed, as follows:

39a. Hearing of State of California Franchise Tax Board, Monday, August 22, 1977, 9:30 a.m.

39b. Hearing of State of California Franchise Tax Board, Tuesday, July 12, 1977, 10:00 a.m.

39c. Hearing, Assembly Revenue and Taxation Committee, Willie L. Brown, Jr., Chairman, Los Angeles, November 1979.

39d. Interim Hearing, Assembly Committee on Revenue and Taxation, San Diego, November 7, 1980.

40. As of January 30, 1986, the United States was a party to income tax treaties for the avoidance of double taxation with thirty-three (33) countries, as follows:

40a. Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation, signed August 6, 1982, entered into force October 31, 1983.

40b. Convention between the Government of the United States of America and the Government of Austria for the Avoidance of Double Taxation, signed October 25, 1956, entered into force October 10, 1957.

40c. Convention between the Government of the United States of America and the Government of Belgium for the Avoidance of Double Taxation, signed July 9, 1970, entered into force October 13, 1972.

40d. Convention between the Government of the United States of America and the Government of Canada for the Avoidance of Double Taxation, signed September 26, 1980, amended by protocols signed June 14, 1983 and March 23, 1984, entered into force August 16, 1984.

40e. Convention between the Government of the United States of America and the Government of Denmark for the Avoidance of Double Taxation, signed May 6, 1948, entered into force December 1, 1948.

40f. Convention between the Government of the United States of America and the Government of Egypt for the Avoidance of Double Taxation, signed August 24, 1980, entered into force December 31, 1981.

40g. Convention between the Government of the United States of America and the Government of Finland for the Avoidance of Double Taxation, signed March 6, 1970, entered into force February 28, 1971.

40h. Convention between the Government of the United States of America and the Government of France for the Avoidance of Double Taxation, signed June 28, 1967, entered into force August 11, 1968, modified by protocol signed October 12, 1970, entered into force February 21, 1971, modified by protocol dated November 24, 1978, entered into force October 27, 1979.

40i. Convention between the Government of the United States of America and the Government of the Federal Republic of Germany for the Avoidance of Double Taxation, signed July 22, 1954, entered into force December 20, 1954, modified by protocol signed September 17, 1965, entered into force December 27, 1965.

40j. Convention between the Government of the United States of America and the Government of Greece for the Avoidance of Double Taxation, signed April 20, 1953, amended by protocol dated April 20, 1953, entered into force December 30, 1953.

40k. Convention between the Government of the United States of America and the Government of Hungary for the Avoidance of Double Taxation, signed February 12, 1979, entered into force September 18, 1979.

40l. Convention between the Government of the United States of America and the Government of Iceland for the Avoidance of Double Taxation, signed May 7, 1975, entered into force December 26, 1975.

40m. Convention between the Government of the United States of America and the Government of Ireland for the Avoidance of Double Taxation, signed September 13, 1949, entered into force December 20, 1951.

40n. Convention between the Government of the United States of America and the Government of Italy for the Avoidance of Double Taxation, signed March 30, 1955, entered into force October 26, 1956.

40o. Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation, signed May 21, 1980, amended by protocol signed May 21, 1980, entered into force December 29, 1981.

40p. Convention between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation, signed March 8, 1971 entered into force July 9, 1972.

40q. Convention between the Government of the United States of America and the Government of Korea for the Avoidance of Double Taxation, signed June 4, 1976, entered into force October 29, 1979.

40r. Convention between the Government of the United States of America and the Government of Luxembourg for the Avoidance of Double Taxation, signed December 18, 1962, entered into force December 22, 1984.

40s. Convention between the Government of the United States of America and the Government of Malta for the avoidance of Double Taxation, signed March 21, 1980, entered into force May 18, 1982.

40t. Convention between the Government of the United States of America and the Government of Morocco for the Avoidance of Double Taxation, signed August 1, 1977, entered into force December 30, 1981.

40u. Convention between the Government of the United States of America and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation, signed April 29, 1948, entered into force December 1, 1948, as modified by supplementary convention signed December 30, 1965, entered into force July 8, 1966.

40v. Convention between the Government of the United States of America and the Government of New Zealand for the Avoidance of Double Taxation, signed July 23, 1982, entered into force November 2, 1983.

40w. Convention between the Government of the United States of America and the Government of Norway for the Avoidance of Double Taxation, signed December 3, 1971, entered into force November 29, 1972, modified by protocol signed September 19, 1980, entered into force December 15, 1981.

40x. Convention between the Government of the United States of America and the Government of Pakistan for the Avoidance of Double Taxation, signed July 1, 1957, entered into force May 21, 1959.

40y. Convention between the Government of the United States of America and the Government of the Philippines for the Avoidance of Double Taxation, signed October 1, 1976, entered into force October 16, 1982.

40z. Convention between the Government of the United States of America and the Government of Poland for the Avoidance of Double Taxation, signed October 8, 1974, entered into force June 22, 1976.

40aa. Convention between the Government of the United States of America and the Government of Romania for the Avoidance of Double Taxation, signed December 4, 1973, entered into force February 26, 1976.

40bb. Convention between the Government of the United States of America and the Government of Sweden for the Avoidance of Double Taxation, signed March 23, 1939, entered into force November 14, 1939, modified by supplementary convention signed October 22, 1963, entered into force September 11, 1964.

40cc. Convention between the Government of the United States of America and the Government of Switzerland for the Avoidance of Double Taxation, signed May 24, 1951, entered into force September 22, 1951.

40dd. Convention between the Government of the United States of America and the Government of Trinidad and Tobago for the Avoidance of Double Taxation, signed January 9, 1970, entered into force December 30, 1970.

40ee. Convention between the Government of the United States of America and the Government of the Republic of South Africa for the Avoidance of Double Taxation, signed December 13, 1946, entered into force July 15, 1952, modified by supplementary protocol signed July 14, 1950, entered into force July 15, 1952.

40ff. Convention between the Government of the United States of America and the Government of the Union of Soviet Socialist Republics for the Avoidance of Double Taxation, signed June 20, 1973, entered into force January 29, 1976.

40gg. Convention between the Government of the United States of America and the Government of the Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed December 31, 1975, entered into force April 25, 1980, modified by notes exchanged on April 13, 1976, amended by first protocol signed August 26, 1976, second protocol signed March 31, 1977, and third protocol signed March 15, 1979, all entered into force July 25, 1980.

41. As of December 16, 1985, the United Kingdom was a party to seventy-eight (78) treaties for the avoidance of double taxation on income, as follows:

41a. Double Taxation Relief (Antigua) Order 1947 (S.R. & O 1947 No. 2865), amended (S.I. 1968 No. 1096).

41b. Double Taxation Relief (Australia) Order 1967 (S.I. 1968 No. 305), protocol (S.I. 1980 No. 707).

41c. Double Taxation Relief (Austria) Order 1970 (S.I. 1947 No. 1947), protocol 1980 (S.I. 1979 No. 117).

41d. Double Taxation Relief (Bangladesh) Order 1979 (S.I. 1980 No. 1947), protocol 1980 (S.I. 1979 No. 708).

41e. Double Taxation Relief (Barbados) Order 1970 (S.I. 1970 No. 952), protocol 1973 (S.I. 1973 No. 2096).

41f. Double Taxation Relief (Belgium) Order 1967 (S.I. 1970 No. 636).

41g. Double Taxation Relief (Belize) Order 1947 (S.R. & O 1947 No. 2866), amended 1962 (S.I. 1968 No. 573), amended 1973 (S.I. 1973 No. 2097).

41h. Double Taxation Relief (Botswana) Order 1977 (S.I. 1978 No. 183).

41i. Double Taxation Relief (Brunei) Order 1950 (S.I. 1950 No. 1977), amended 1968 (S.I. 1968 No. 306), amended 1973 (S.I. 1973 No. 2098).

41j. Double Taxation Relief (Burma) Order 1950, protocol 1951 (S.I. 1952 No. 751).

41k. Double Taxation Relief (Canada) Order 1978 (S.I. 1980 No. 709), protocol 1980 (S.I. 1980 No. 1528), protocol (S.I. 1985 No. 1996).

41l. Double Taxation Relief (China) Order 1984 (S.I. 1984 No. 1826).

41m. Double Taxation Relief (Cyprus) Order 1974 (S.I. 1975 No. 425), protocol 1980 (S.I. 1980 No. 1529).

41n. Double Taxation Relief (Denmark) Order 1980 (S.I. 1980 No. 1960).

41o. Double Taxation Relief (Dominican Republic) Order 1949 (S.I. 1949 No. 359), amended 1968 (S.I. 1968 No. 1098).

41p. Double Taxation Relief (Egypt) Order 1980 (S.I. 1980 No. 1091).

41q. Double Taxation Relief (Falkland Islands) Order 1984 (S.I. 1984 No. 363).

41r. Double Taxation Relief (Faroe Islands) Order 1950 (S.I. 1950 No. 1195), extended 1960 (S.I. 1961 No. 579), protocol 1969 (S.I. 1969 No. 1068), extended 1970 (S.I. 1971 No. 717), protocol 1973 (S.I. 1973 No. 1326), extended 1975 (S.I. 1975 No. 2190).

41s. Double Taxation Relief (Fiji) Order 1975 (S.I. 1976 No. 1342).

41t. Double Taxation Relief (Finland) Order 1969 (S.I. 1970 No. 153), protocol 1979 (S.I. 1980 No. 710), protocol 1984 (S.I. 1985 No. 1997).

41u. Double Taxation Relief (France) Order 1968 (S.I. 1968 No. 1869), protocol 1973 (S.I. 1973 No. 1328).

41v. Double Taxation Relief (Gambia) Order 1980 (S.I. 1980 No. 1963).

41w. Double Taxation Relief (Federal Republic of Germany) Order 1964 (S.I. 1967 No. 25), protocol 1970 (S.I. 1971 No. 874).

41x. Double Taxation Relief (Ghana) Order 1977 (S.I. 1978 No. 785).

41y. Double Taxation Relief (Greece) Order 1953 (S.I. 1954 No. 142).

41z. Double Taxation Relief (Grenada) Order 1949 (S.I. 1949 No. 361), amended 1968 (S.I. 1968 No. 1867).

41aa. Double Taxation Relief (Guernsey) Order 1952 (S.I. 1952 No. 1215).

41bb. Double Taxation Relief (Hungary) Order 1977 (S.I. 1978 No. 1056).

41cc. Double Taxation Relief (India) Order 1981 (S.I. 1981 No. 1120).

41dd. Double Taxation Relief (Indonesia) Order 1975 (S.I. 1975 No. 2191).

41ee. Double Taxation Relief (Republic of Ireland) Order 1976 (S.I. 1976 No. 2151), protocol 1976 (S.I. 1976 No. 2152).

41ff. Double Taxation Relief (Isle of Man) Order 1955 (S.I. 1955 No. 1205).

41gg. Double Taxation Relief (Israel) Order 1962 (S.I. 1962 No. 616), protocol 1970 (S.I. 1971 No. 391).

41hh. Double Taxation Relief (Italy) Order 1960, exchange of notes 1960 (S.I. 1962 No. 2787), protocol 1969 (S.I. 1973 No. 1763).

41ii. Double Taxation Relief (Jamaica) Order 1973 (S.I. 1973 No. 1329).

41jj. Double Taxation Relief (Japan) Order 1969, exchange of notes 1969 (S.I. 1970 No. 1948), protocol 1980 (S.I. 1980 No. 1530).

41kk. Double Taxation Relief (Jersey) Order 1952 (S.I. 1952 No. 1216).

41ll. Double Taxation Relief (Kenya) Order 1973, protocol 1976, exchange of notes 1977 (S.I. 1977 No. 1299).

41mm. Double Taxation Relief (Kiribati and Tuvalu) Order 1950 (S.I. 1950 No. 750), amended 1968 (S.I. No. 309), amended 1974 (S.I. 1974 No. 1271).

41nn. Double Taxation Relief (Korea) Order 1977, protocol 1977 (S.I. 1978 No. 786).

41oo. Double Taxation Relief (Lesotho) Order 1949 (S.I. No. 2197), amended 1968 (S.I. 1968 No. 1868).

41pp. Double Taxation Relief (Luxembourg) Order 1967 (S.I. 1968 No. 1100), protocol 1978 (S.I. 1980 No. 567), protocol 1983 (S.I. 1984 No. 364).

41qq. Double Taxation Relief (Malawi) Order 1955 (S.I. 1956 No. 619), amended 1964 (S.I. 1964 No. 1401), amended 1968 (S.I. 1968 No. 1101), amended 1978 (S.I. 1978 No. 302).

41rr. Double Taxation Relief (Malaysia) Order 1973, protocol 1973 (S.I. 1973 No. 1330).

41ss. Double Taxation Relief (Malta) Order 1962 (S.I. 1962 No. 639), amended 1974 (S.I. 1975 No. 426).

41tt. Double Taxation Relief (Mauritius) Order 1981 (S.I. 1981 No. 1121).

41uu. Double Taxation Relief (Montserrat) Order 1947 (S.I. 1947 No. 2868), amended 1968 (S.I. 1968 No. 576).

41vv. Double Taxation Relief (Namibia) Order 1962 (S.I. 1962 No. 2352), extended 1962 (S.I. 1962 No. 2788), protocol 1967 (S.I. 1967 No. 1489), extended 1967 (S.I. 1967 No. 1460).

41ww. Double Taxation Relief (Netherlands) Order 1980 (S.I. 1980 No. 1961), protocol 1983 (S.I. 1983 No. 1902).

41xx. Double Taxation Relief (Netherlands Antilles) Order 1967 (S.I. 1968 No. 577), extended 1970 (S.I. 1970 No. 1949).

41yy. Double Taxation Relief (New Zealand) Order 1983, exchange of notes 1983 (S.I. 1984 No. 365).

41zz. Double Taxation Relief (Norway) Order 1985 (S.I. 1985 No. 1998).

41aaa. Double Taxation Relief (Pakistan) Order 1961 (S.I. 1961 No. 2467).

41bbb. Double Taxation Relief (Philippines) Order 1976 (S.I. 1978 No. 184).

41ccc. Double Taxation Relief (Poland) Order 1976 (S.I. 1978 No. 282).

41ddd. Double Taxation Relief (Portugal) Order 1968 (S.I. 1969 No. 599).

41eee. Double Taxation Relief (Romania) Order 1975, exchange of notes 1976 (S.I. 1977 No. 57).

41fff. Double Taxation Relief (St. Christopher & Nevis (St. Kitts)) Order 1947 (S.I. 1947 No. 2872).

41ggg. Double Taxation Relief (St. Lucia) Order 1949 (S.I. 1949 No. 366), amended 1968 (S.I. 1968 No. 1102).

41hhh. Double Taxation Relief (St. Vincent & Grenadines) Order 1949 (S.I. 1949 No. 367), amended 1968 (S.I. 1968 No. 1103).

41iii. Double Taxation Relief (Sierra Leone) Order 1947 (S.I. 1947 No. 2873), amended 1968 (S.I. 1968 No. 1104).

41jjj. Double Taxation Relief (Singapore) Order 1966 (S.I. 1967 No. 483), protocol 1975, exchange of notes 1975, 1976, 1977 (S.I. 1978 No. 787).

41kkk. Double Taxation Relief (Solomon Islands) Order 1950 (S.I. 1950 No. 748), amended 1968 (S.I. 1968 No. 574), amended 1974 (S.I. 1974 No. 1270).

41lll. Double Taxation Relief (South Africa) Order 1968 (S.I. 1969 No. 864).

41mmm. Double Taxation Relief (Spain) 1975 (S.I. 1976 No. 1919).

41nnn. Double Taxation Relief (Sri Lanka) Order 1979, exchange of notes 1980 (S.I. 1980 No. 713).

41ooo. Double Taxation Relief (Sudan) Order 1975 (S.I. 1979 No. 1719).

41ppp. Double Taxation Relief (Swaziland) Order 1968 (S.I. 1968 No. 380).

41qqq. Double Taxation Relief (Sweden) Order 1983 (S.I. 1984 No. 366), protocol 1984 (S.I. 1984 No. 366).

41rrr. Double Taxation Relief (Switzerland) Order 1977 (S.I. 1978 No. 1408), protocol 1981 (S.I. 1982 No. 714).

41sss. Double Taxation Relief (Thailand) Order 1981 (S.I. 1981 No. 1546).

41ttt. Double Taxation Relief (Trinidad & Tobago) Order 1982 (S.I. 1983 No. 1903).

41uuu. Double Taxation Relief (Tunisia) Order 1982 (S.I. 1984 No. 1336).

41vvv. Double Taxation Relief (Uganda) Order 1952 (S.I. 1952 No. 1213).

41www. Double Taxation Relief (United States of America) Order 1975, exchange of notes 1976, protocol 1976, protocol 1977, protocol 1979 (S.I. 1980 No. 568).

41xxx. Double Taxation Relief (Yugoslavia) Order 1981 (S.I. 1981 No. 1815).

41yyy. Double Taxation Relief (Zambia) Order 1972 (S.I. 1972 No. 1721), protocol 1981 (S.I. 1981 No. 1816).

41zzz. Double Taxation Relief (Zimbabwe) Order 1982 (S.I. 1982 No. 1842).

42. By an exchange of notes dated September 26, 1980, between the Honorable Allan J. MacEachen, Deputy Prime Minister and Minister of Finance of Canada and G. William Miller, Secretary of Treasury of the United States, in conjunction with the execution of the Convention For Avoidance of Double Taxation between the United States and Canada, the Government of Canada set forth its position on the issue of the so-called "unitary apportionment" method used by certain states of the United States and the United States agreed to reopen discussions with Canada on this subject if an acceptable provision on this subject can be devised.

43. By an exchange of notes dated November 24, 1978, between George S. Vest, Assistant Secretary of State for European Affairs, and Francois de Laboulaye, Ambassador of France, in conjunction with the execution of the protocol dated November 24, 1978, to the Convention for the Avoidance of Double Taxation between the United States and France, the Government of France set forth its position on the so-called "unitary apportionment" method used by certain states of the United States, and the Government of the United States and the Government of the United States agreed to reopen discussions with France on this subject if an acceptable provision on this subject can be devised.

44. In 1963, the Committee on Fiscal Affairs to the Council of the Organization for Economic Co-operation and Development ("OECD") published the Draft Double Taxation Convention on Income and Capital. In 1977, the OECD revised and published its new Model Double Taxation Convention on Income and on Capital. The conventions are both contained in the 1977 Report of the OECD Committee on Fiscal Affairs, "Model Double Taxation Convention on Income and on Capital."

45. In 1977, the Government of the United States of America published its Model Convention For the Avoidance of Double Taxation on Income and Capital. This document was revised in 1981 and is entitled "United States Draft Model Income Tax Treaty."

46. Correspondence, statements or press releases from various government officials throughout the United States have been issued, some of which are as follows:

46a. Letter from Secretary of Treasury, James A. Baker III to the President of the United States Senate regarding the introduction of Unitary Tax Repealer Act, dated December 18, 1985.

46b. Letter from the Honorable Barber B. Conable, Jr. to the Honorable John E. Chapoton with enclosed statement of the Honorable Conable to be submitted to the Unitary Taxation Group's Task Force, dated November 23, 1983.

46c. Letter to the Honorable Barber B. Conable, Jr. from the Honorable Donald C. Lubick, Assistant Secretary of the Treasury regarding unitary taxation, dated April 22, 1980.

46d. Statement by the Honorable Allen Wallis, Under Secretary of State for Economic Affairs concerning the Chairman's Working Group Report, as taken from the Final Report of the Worldwide Unitary Taxation Group, August 1984.

46e. Statement by the Honorable Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy, before the Senate Finance Subcommittee on Taxation and Debt Management Generally on S. 983 and S. 1688, dated June 24, 1980.

46f. Statement by the Honorable Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy, before the House Ways and Means Committee on H.R. 5076, dated March 31, 1980.

46g. Press release #255 from the Office of the Governor of California regarding California's unitary tax, dated May 1, 1984.

46h. Letter from the Honorable George P. Schultz to the Honorable George Deukmejian regarding unitary taxation, dated January 30, 1986.

46i. Reply from Honorable George Deukmejian to the letter of January 30, 1986, from the Honorable George P. Schultz.

47. The Organization for Economic Co-operation and Development (OECD) issued a report on transfer pricing entitled "Transfer Pricing and Multinational Enterprises" (Paris OECD, 1979).

48. The Organization for Economic Co-operation and Development (OECD) issued a report on transfer pricing entitled "Transfer Pricing and Multinational Enterprises, Three Taxation Issues" (Paris OECD, 1984).

49. The administration of Internal Revenue Code Section 482 by the Internal Revenue Service, and its effectiveness generally, has been studied and reported on by certain governmental agencies of the United States, as follows:

49a. Comptroller General of the United States, No. GGD-51-81, Report to the Chairman, House Committee on Ways and Means, IRS Could Better Protect U.S. Tax Interests in Determining the Income of Multinational Corporations (September 30, 1981).

49b. Report to the Associate Commissioner of the Internal Revenue Service, Internal Revenue Service of Study of International Cases Involving Section 482 of the Internal Revenue Code (1982).

50. State taxation of multinational corporations has been the subject of reports, some of which are:

50a. "Key Issues Affecting State Taxation of Multi-jurisdictional Corporate Income Need Resolving", a report to the Chairman of the House Committee on Ways and Means from the Comptroller General of the United States and published on July 1, 1982 in the General Accounting Office.

50b. Report of the Advisory Commission on Intergovernmental Relations, "State Taxation of Multi-national Corporations" dated November 1982.

50c. Report of Advisory On Intergovernmental Relations, "State Taxation of Multinational and Multistate Corporations" dated September 4, 1981.

51. Internal records of members of the Barclays Group were produced by plaintiffs to defendants in discovery, some of which are as follows:

51a. Letter from A. H. Dalton to I. M. Cobbold, Esq., dated August 3, 1979. (000176-000177)

51b. Letter dated P. J. Chapman to G. J. Lyall, Esq., dated April 13, 1983. (000594-000595)

51c. Letter from Price Waterhouse to Secretary, Inland Revenue, dated April 1, 1982. (000631-000633)

51d. Letter from J. A. Dally to Price Waterhouse, dated May 13, 1982. (000630)

51e. BBL Reports and Accounts - 1977. (000256-000308)

51f. BBI Reports and Accounts - 1977. (000221-000255)

51g. Preliminary Prospectus dated March 31, 1981 $125,000,000 Barclays North American Capital Corporation % Guaranteed Capital Notes due 2006. (000424-000521)

51h. Barclays International-World of Banking — List of Offices Nov. 1977. (000309-000423)

51i. Barclays Bank International Limited claim for double tax relief — September 30, 1977. (000639-000646)

51j. Reconciliation between agreed local taxable profit and UK adjusted profit for purposes of double tax relief September 30, 1977. (000801-000828)

51k. A-T Schedule for Barclays Bank of California for the income year 1977. (002064-002092)

51l. Annual Return/Report of Employee Benefit Plan — U.S. Form 5500 and supporting documents. (003131-003160)

51m. Barclays Bank of California U.S. Corporation Income Tax Return for Income Year 1977 — U.S. Form 1120 and supporting documents. (003261-003209)

51n. BBI U.S. Corporate Income Tax for Income Year 1977 — Form 1120F. (003217-003225)

51o. Barclays Bank of California — California tax return for income year ending September 30, 1977. (003226-003250)

51p. BBI California tax return for income year ending September 30, 1977. (003251-003261)

51q. Barclays Group Management Accounts — December 31, 1977. (003610-003614)

51r. Barclays Group-Supporting schedules to financial accounts December 31, 1977. (003615-003629)

51s. The Barclays Group-Divisional Operating Profit; Reconciliation of Financial and Management Results. (003630-003687)

51t. Interest in subsidiaries and associated companies, December 31, 1977.

51u. Consolidation Schedules. (003708-003752)

51v. Letter D. Elvidge, Head Group Taxation Barclays Plc to J.H. Hall, Inland Revenue dated April 14, 1986.

51w. Letter J.H. Hall, Inland Revenue to David Elvidge, Head Group Taxation Barclays Plc, dated April 16, 1986.

This stipulation is made this 9th day of September, 1986.

JOANNE M. GARVEY LAWRENCE W. JORDAN, JR. JOAN K. IRION JORDAN, KEELER & SELIGMAN	JOHN VAN DE KAMP, Attorney General of the State of California EDWARD P. HOLLINGSHEAD, Supervising Deputy Attorney General
By ____________________ Joanne M. Garvey Counsel for Plaintiffs	By ____________________ Robert Milam Deputy Attorney General Counsel for Defendant

CERTIFICATE OF SERVICE BY MAIL

I, Rhoda L. Fone, declare that I am a citizen of the United States, over the age of 18, and not a party to or interested in the within entitled cause; that I am an employee of JORDAN, KEELER & SELIGMAN, and that my business address is 1400 Alcoa Building, One Maritime Plaza, San Francisco, California 94111; that on November 3, 1986, I served the within JOINT STIPULATION OF FACTS by placing a true copy thereof in a sealed envelope with postage fully prepaid, in the United States Post Office mail box, in the City and County of San Francisco, California addressed as follows:

Robert D. Milam, Esq.
Deputy Attorney General
1515 K Street
Sacramento, California 94244-2550

I declare under penalty of perjury that the foregoing is true and correct.

Executed on November 3, 1986, at San Francisco, California.

____
Rhoda L. Fone

JOHN K. VAN DE KAMP, Attorney
General of the State of California
TIMOTHY G. LADDISH
Supervising Deputy Attorney General
RICHARD E. NEILSEN
ROBERT D. MILAM
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P.O. Box 944255
Sacramento, CA 94244-2550
Telephone: (916) 324-5156
Attorneys For Defendant

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LTD.,
a corporation of the
Country of England,
Plaintiff,

vs.

FRANCHISE TAX BOARD, an agency
of the State of California,
Defendant.

BARCLAYS BANK OF CALIFORNIA,
a California Corporation,
Plaintiff,

vs.

FRANCHISE TAX BOARD, an agency
of the State of California,
Defendant.

No. 325059 — No. 325061
(Consolidated for Purposes of Trial)

FILED: November 10, 1986
Joyce Russell Smith, Clerk

By S. GODFREY
Deputy

SCHEDULE II

SECOND STIPULATION OF FACTS AND DOCUMENTS

IT IS HEREBY STIPULATED by and between the parties, through their attorneys of record, that the following further facts and documents are agreed to and undisputed. This stipulation shall not be construed as a concession by either party of the relevancy or materiality of any of the facts stipulated, and the parties reserve the right to argue the relevance, materiality or weight of any of the facts stipulated.

All further documents referred to herein or specifically enumerated are compiled under separate cover, have been reviewed by counsel for the parties and their authenticity and foundational basis admitted. The documents shall be entered into evidence. Nothing contained in this stipulation shall prevent a party from introducing at trial any other or further evidence. With permission of Court, documents described in paragraphs 32, 40, and 41 hereof will be deemed admitted in evidence in entirety without physically presenting the same at trial. Either party may refer to said documents in summary form or as individual exhibits at trial or on appeal as evidence admitted at trial.

Nothing contained herein shall be construed as a waiver by any party of its right to review on appeal any question of law or fact arising in this action in the same manner and to the same extent as if the facts set forth herein had been proven in open court.

This stipulation shall only apply to the above-entitled consolidated actions and to any appeals from the judgment of this Court.

FACTS AND DOCUMENTS

The following facts are agreed to and undisputed and the following documents shall be entered into evidence:

28. Continued

28a. Announcement of the Establishment of the Working Group. 48 Fed. Reg. No. 208, page 49570, October 26, 1983.

32. Continued

32ff. Demarche from Greece, as President of the EEC, on behalf of the Ten European Economic Community Governments to the Department of State, Washington D.C. dated September 23, 1983 with attached Note.

32gg. Aide-memoire from the Government of Japan to the United States Government, dated August 11, 1983.

32hh. Demarche from the Embassy of Ireland as President of the EEC, on behalf of the governments of member states and the Commission of the European Communities to the Department of State, dated December 20, 1984.

32ii. Note Verbale of the Delegation of the Commission of the European Communities and the Embassy of Luxembourg on behalf of the EEC, to the Department of State, dated August 8, 1985.

32jj. Demarche from the Ambassador of Luxembourg and the Head of the Delegation of the Commission of the European Communities to the Department of State, dated August 30, 1985 with attached letter to Treasury Secretary Baker dated August 30, 1985 and attached Note Verbal.

32kk. Note on Worldwide Unitary Taxation from J. Raoul Schoumaker, Ambassador of Belgium, on behalf of the Member States of the European Commission and the Ambassador of Australia, Canada, Japan and Switzerland to Under Secretary of State Allen Wallis and Treasury Secretary Donald Regan, dated January 27, 1984 with cover letter, dated January 30, 1984, enclosing the same to Sir Roy Denman, Head of the Delegation of the Commission of the European Communities.

32ll. Motion for Resolution of the EEC dated October 27, 1983.

37. Continued

37h. Hearing before the Committee on Foreign Relations of the United States Senate on Six International Tax Treaties and Protocols, 96th Congress, 1st Sess. (June 6, 1979).

37i. Hearing before the Subcommittee on Taxation and Debt Management of the Congress on Finance on S.1113 and S.1974, 99th Congress, 2d Sess. (September 29, 1986).

46. Continued

46j. Letter from Michael Blumenthal, Secretary of Treasury to Martin Huff, Executive Officer California Franchise Tax Board, February 15, 1977.

46k. Letter from John S. Chapoton, Assistant Secretary Treasury (Tax Policy) to William J. Anderson, Director, General Government Division U.S., GAO Washington D.C., dated July 10, 1981.

46l. Letter from Donald Regan, Secretary of Treasury, to William Brock, United States Trade Representative, dated February 12, 1982.

46m. Letter from William Brock, United States Trade Representative to Donald Regan, Secretary of Treasury, dated February 22, 1982.

46n. Letter from Treasury Secretary James A. Baker III to House Ways and Means Committee Chairman, Dan Rostenkowski, dated March 5, 1986.

46o. Letter from Treasury Secretary James A. Baker III to Senate Finance Committee Chairman Bob Packwood, dated March 17, 1986.

46p. Letter from Treasury Secretary James A. Baker III to Speaker of the House of Representatives, Hon. Thomas P. O'Neill, Jr., dated December 18, 1985.

51. Continued

51x. BBI 1977 New York State Tax Return (Doc. No. 32678-3271).

53. The United Nations Model Double Taxation Convention Between Developed and Developing Countries, 1980.

54. United Kingdom Government Statement in Response to the Statement of the President dated November 8, 1985.

55. California Senate Bill 85 (Alquist) signed by Governor Deukmejian September 5, 1986, an act to add Chapter 1.9 (commencing with Section 15365), Chapter 6 (commencing with Section 15397) and Chapter 7 (commencing with Section 15398) to Part 6.7 of Division 3 of, and to add Article 12 (commencing with Section 16429.30) to Chapter 2 of Part 2 of Division 4 of, Title 2 of, the Government Code, to amend Sections 24274, 24344, 24348, 24667, and 24668 of, to amend and renumber Section 25110 of, to add Sections 24411 and 24670 to, and to add and repeal Article 1.5 (commencing with Section 25110) of Chapter 17 of Part 11 of Division 2 of, the Revenue and Taxation Code, relating to taxation.

56. United Kingdom Government Statement in Response to passage of Senate Bill 85, dated 5 September 1986.

57. Memo to File from Benjamin F. Miller regarding UDITPA Regulations 25137(m) and 25137(o) dated September 23, 1981 with attached Proposed Guidelines for the Preparation of Combined Reports which Include Foreign Country Operations.

58. Summary of Comments, Responses and Recommendations on Proposed Regulation 25137(m) Combined Reports Including Foreign Country Operation.

59. Summary of Comments Received Regarding FTB 1046 (12-79) and Department Responses.

60. US/USSR Treaty hearings and documents including letter from George Shultz to Nikolai Patolicher, Report of the Department of State, and the Report of the Senate Foreign Relations Committee.

This stipulation is made this 10th day of November, 1986.

JOANNE M. GARVEY
LAWRENCE W. JORDAN, JR.
JOAN K. IRION
JORDAN, KEELER & SELIGMAN

JOHN VAN DE KAMP, Attorney General of the State of California
EDWARD P. HOLLINGSHEAD, Supervising Deputy Attorney General

By ______________________
Joanne M. Garvey
Counsel for Plaintiffs

By ______________________
Robert Milam
Deputy Attorney General
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Attorneys for Defendant

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK OF CALIFORNIA,
a California Corporation,
Plaintiff,

v.

FRANCHISE TAX BOARD, an agency
of the State of California,
Defendant.

BARCLAYS BANK INTERNATIONAL, LIMITED,
a corporation of the Country of England,
Plaintiff,

v.

FRANCHISE TAX BOARD, an agency
of the State of California,
Defendant.

No. 325061
No. 325059

ENDORSED
Filed: December 20, 1985
Joyce Russell Smith, Clerk
By J.L. Holloway, Deputy

STIPULATION AND ORDER REGARDING CLOSE OF DISCOVERY

IT IS HEREBY STIPULATED AND AGREED By Plaintiffs, Barclays Bank of California and Barclays Bank International Limited, and Defendant, The Franchise Tax Board, the parties hereto, by and through their respective counsel of record, that discovery for all matters shall close at the conclusion of business on February 14, 1986, which is ten days prior to trial.

DATED: December 10, 1985

JOHN K. VAN DE KAMP
Attorney General

EDWARD P. HOLLINGSHEAD
Supervising Deputy Attorney

By: ______________________
ROBERT D. MILAM
Deputy Attorney General

Attorneys for Defendant
Franchise Tax Board

DATED: December 10, 1985

JORDAN, KEELER & SELIGMAN

By: ______________________
JOAN K. IRION

Attorneys for Plaintiffs
Barclays Bank of California and
Barclays Bank International
Limited

ORDER

IT IS SO ORDERED.

DATED: December 20, 1985

FRED W. MARLER JR. (CCP635)
Acting Presiding Judge
JUDGE OF THE SUPERIOR COURT

APPENDIX B

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF
THE STATE OF CALIFORNIA IN AND FOR
THE THIRD APPELLATE DISTRICT
(Sacramento)

BARCLAYS BANK INTERNATIONAL, LTD.,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

BARCLAYS BANK OF CALIFORNIA,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

C003388
(Super. Ct. Nos. 325059 & 325061)

Filed November 30, 1990

COURT OF APPEAL - THIRD DISTRICT

BY Robert L. Liston, Clerk
DEPUTY

APPEAL from judgments of the Superior Court of Sacramento County, George E. Paras, Retired Associate Justice of the Court of Appeal, sitting under assignment by the Chairperson of the Judicial Council. Affirmed.

John K. Van de Kamp, Attorney General, Timothy G. Laddish, Assistant Attorney General, Robert F. Tyler, Supervising

Deputy Attorney General, and Robert D. Milam, Deputy Attorney General, for Defendant and Appellant.

Joanne M. Garvey, Joan K. Irion, Teresa A. Maloney, and Heller, Ehrman, White & McAuliffe, for Plaintiffs and Respondents.

Lawrence V. Brookes and Valentine Brookes as Amici Curiae for Thorn-EMI PLC and EMI Limited, on behalf of Plaintiffs and Respondents.

Jane H. Barrett, Lawler, Felix & Hall, and F. Eugene Wirwahn as Amici Curiae for the Government of the United Kingdom and the Government of Canada, on behalf of Plaintiffs and Respondents.

David F. Levi, United States Attorney, William S. Rose, Jr., Assistant Attorney General, and Gary R. Allen, David English Carmack, John J. McCarthy, and Richard A. Correa, Attorneys, Department of Justice, as Amicus Curiae for the United States of America, on behalf of Plaintiffs and Respondents.

In this appeal we hold that California's unitary tax method of worldwide combined reporting (based on Rev. & Tax. Code, §§ 25101, 25120-25138), as applied to foreign-based unitary groups, is unconstitutional under the foreign commerce clause of the United States Constitution. (U.S. Const., art. I, § 8, cl. 3.)[1]

BACKGROUND

When a corporation conducts business in more than one jurisdiction, either through branches or subsidiaries, the proper allocation of income for tax purposes becomes an issue. Essentially, two methods of allocating income have evolved to resolve this issue: the arm's length/separate accounting method (AL/SA) and the unitary business/formula apportionment method. As to multinational corporations, California employs a common variant of the unitary method called worldwide combined reporting (WWCR).

Under the separate accounting method, the various affiliated corporations of a multijurisdictional enterprise are viewed as separate from one another and the income attributable to any particular jurisdiction is determined on the basis of internal accounting records reflecting the activity of the affiliate within that jurisdiction. To preclude tax-manipulative intercorporate transfers of goods, services or other value, this accounting method requires that the tax reporting entity deal at "arm's length" with its affiliated businesses as if they were simply unrelated entities dealing in the marketplace.

In contrast, under the unitary business/formula apportionment method of accounting employed by California (WWCR), the affiliated corporations of a multijurisdictional enterprise are treated as units of a single business — that is, as a "unitary group." (Cal. Code Regs., tit. 18, § 25137-6.) If a corporation doing business in California is deemed to be part of a unitary group, the total income for that group, including corporations or affiliates operating wholly outside California or the United States for that matter, is apportioned to California by a three-factor formula. The formula takes into account property, payroll, and sales (revenue in this case) for the group in California, as a fraction of total worldwide property, payroll, and sales. (See Rev. & Tax. Code, §§ 25128-25136; Notes, *State Worldwide Unitary Taxation: The Foreign Parent Case* (1985) 23 Columbia Journal of Transnational Law 445, fn. 2; hereafter 23 Columbia Journal.) The fraction is then multiplied against the unitary group's total

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[1]During the tax year at issue (1977), section 25101 of the Revenue and Taxation Code provided in pertinent part as follows: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120 of this chapter); . . ."

Article 2 contains the California enactment of the Uniform Division of Income for Tax Purposes Act (UDITPA), which provides for formula apportionment of the net income from business activities both within and outside California in order to reach the net income attributable to California activities. (Rev. & Tax. Code, §§ 25120-25138.)

In 1982, section 25101 was amended in an insignificant fashion for our purposes. (Stats. 1982, ch. 466, § 104, p. 2055.)

income, producing an apportioned amount of such income taxable by California. Because intercorporate transactions are disregarded, it is unnecessary to make "arm's length" adjustments.

The income allocation method used by the United States and all of the other nations of the world, with a couple of minor and limited exceptions, is the AL/SA method, although this method varies in practice. However, the United States has essentially limited the application of its tax treaties to federal taxes. Apparently no nation in the world uses WWCR in any meaningful fashion.

The present controversy involves challenges to additional tax assessments for the year 1977 resulting from California's use of WWCR.[2] Those additional assessments were levied after the

[2]In 1986, California passed legislation, operative January 1, 1988, permitting taxpayers to make a "water's-edge election" notwithstanding section 25101 (Rev. & Tax. Code, § 25110 et seq.).

The "water's-edge" method is essentially an AL/SA method, and offers an alternative to the WWCR method for determining taxable income. (See Rev. & Tax. Code, §§ 25101, 25110.) Instead of accounting for the income and apportionment factors (property, payroll, and sales) of all the members of its worldwide unitary group, a corporate taxpayer making such an election accounts for the income and apportionment factors of the following entities affiliated with it, subject to some technical exceptions: corporations incorporated in the United States; any corporation, wherever incorporated, if the average of its apportionment factors within the United States is 20 percent or more; affiliated corporations which are eligible to be included in a federal consolidated tax return; domestic international sales corporations and foreign sales corporations engaged in sales in the United States; export trade corporations; any corporation not set forth previously but only to the extent of its income derived from or attributable to sources within the United States; and any affiliated corporation which is a controlled foreign corporation as defined in the Internal Revenue Code. Any corporation not subjected to WWCR under Revenue and Taxation Code section 25101 need not be included in this "water's-edge" accounting. (Rev. & Tax. Code, § 25110, subd. (a).)

In general, this election permits a taxpayer corporation to exclude the income and apportionment factors of foreign incorporated affiliates from the corporation's California tax base. In the context of state taxation of multinational corporations, an accounting restriction to the water's edge of the United States means that a state tax authority relies only on income derived from permanent establishments of the corporation in the United States, and not on income derived from wholly foreign interests, to calculate the corporation's franchise tax. Essentially, then, California's "water's-edge election" is a separate accounting method with the United States as the jurisdictional boundary.

Only "qualified taxpayers" can make a water's-edge election. To qualify, the corporate taxpayer must (1) consent to the taking of depositions from key corporate personnel and to the production of documents to ensure the Franchise Tax Board has the information necessary to make genuine arm's length adjustments and unitary business investigations, and (2) agree that dividends received by any affiliated entity from corporations significantly related to the unitary business constitute business income of the taxpayer. (Rev. & Tax. Code, § 25110, subd. (b) (2).) Additionally, to make the election the corporate taxpayer must enter into a five-year contract with the Franchise Tax Board, pay an annual fee, and subject itself to various conditions. (Rev. & Tax. Code, §§ 25111-25115.)

A foreign-based multinational corporation that does not make this election is subjected essentially to the 1977 taxation method at issue here. (See fn. 1, *ante*, pp. 2-3.) We emphasize, however, that the issue we confront is the constitutionality of California's unitary tax method of WWCR as applied to foreign-based unitary groups (Rev. & Tax. Code, § 25101 et seq.). Because California's "water's-edge election" is not involved in this case, we express no view regarding it. (Rev. & Tax. Code, § 25110 et seq.)

defendant California Franchise Tax Board (Board) determined that the plaintiff taxpayers, Barclays Bank of California (Barcal) and Barclays Bank International (BBI), and their ultimate corporate parent, Barclays Bank Limited (BBL), as well as the significant subsidiaries of BBI and BBL, constituted a unitary group.[3] Barcal was directed to pay an additional $152,420 and BBI an additional $1,678. Under protest Barcal and BBI (hereafter referred to collectively as either plaintiffs or Barclays) paid the additional taxes and this suit ensued.

[3]Barcal and BBI do not challenge the determination that they are part of a unitary group.

Plaintiffs challenge the federal constitutionality of these additional tax assessments on foreign commerce clause and due process grounds. For us, the critical issue concerns the foreign commerce clause.

Foreign Commerce Clause

Before beginning our analysis, we note that plaintiffs also contend the WWCR unitary method is unconstitutional because it improperly interferes with the power of the executive branch of the federal government to conduct foreign affairs. (See United States v. Curtiss-Wright Export Corp. (1936) 299 U.S. 304 [81 L.Ed 255].) The Board argues here, as it did below, that plaintiffs' failure to raise the latter issue in their claim for refund precludes their assertion on appeal. The trial court rejected the argument, reasoning that the protest proceedings provided adequate notice of the issue and, more importantly, the Board lacked the authority to address constitutional issues. There is substantial evidence supporting the trial court's determination of adequate notice; it would have been a futile exercise to raise this constitutional issue involving sensitive matters of international relations before the Board. (See Park'N Fly of San Francisco, Inc. v. City of South San Francisco (1987) 188 Cal.App.3d 1201, 1208-1209, 1215-1216.) Moreover, as we shall explain, the dispute is irrelevant as the foreign commerce clause issue inextricably involves foreign affairs, the subject of foreign affairs inextricably involves the two political branches of our national government, and the foreign commerce clause issue was undeniably raised in a timely fashion. With these prefatory remarks in mind, we address the substance of the matter.

Article I, section 8, clause 3 of the United States Constitution gives Congress the power "To regulate commerce with foreign nations, and among the several states, . . ."

As noted by the trial court, three United States Supreme Court decisions that have construed this provision in the last decade are vital to the positions of each of the parties to this litigation. Those cases are: Japan Line, Ltd. v. County of Los Angeles (1979) 441 U.S. 434 [60 L.Ed.2d 336]; Container Corp. v. Franchise Tax

Bd. (1983) 463 U.S. 159 [77 L.Ed.2d 545]; and Wardair Canada v. Florida Dept. of Revenue (1986) 477 U.S. 1 [91 L.Ed.2d 1].

In *Japan Line,* the high court held that instrumentalities of commerce (in that case, cargo containers in seagoing ships) that are owned, based, and registered abroad and that are used exclusively in international commerce may not be subjected to an apportioned ad valorem property tax by a state. (441 U.S. at pp. 436, 444 [60 L.Ed.2d at pp. 340, 345].)

Through *Japan Line,* the so-called "dormant" foreign commerce clause test of constitutional review came into being. The judiciary engages in dormant commerce clause analysis when the Congress has not acted or purported to act; in such situations, it is the judiciary's responsibility to determine whether an action taken by a state unduly threatens the underlying purpose of the clause: to ensure a free flow of commerce and that individual states do not work to the detriment of the nation as a whole. (Merrion v. Jicarilla Apache Tribe (1982) 455 U.S. 130, 154-155 [71 L.Ed.2d 21, 40]; *Wardair, supra,* 477 U.S. at pp. 7-8 [91 L.Ed.2d at pp. 9-10].)

This dormant foreign commerce clause test was engendered through the engrafting of two additional inquiries onto the already existing four-part test for dormant *Interstate* commerce clause review. (*Japan Line, supra,* 441 U.S. at pp. 444-445, 451 [60 L.Ed.2d at pp. 345-346, 349].)

That four-part test upholds a state tax against an interstate commerce clause challenge if the tax "'[i] is applied to an activity with a substantial nexus with the taxing State, [ii] is fairly apportioned, [iii] does not discriminate against interstate commerce, and [iv] is fairly related to the services provided by the State.'" (*Japan Line, supra,* 441 U.S. at pp. 444-445, 449, 454 [60 L.Ed.2d at pp. 345, 348, 351], quoting Complete Auto Transit, Inc. v. Brady (1977) 430 U.S. 274, 279 [51 L.Ed.2d 326, 331].) The two additional inquiries prompted by the foreign context are first, whether the tax creates a "substantial risk of international multiple taxation" (441 U.S. at p. 451 [60 L.Ed.2d at p. 349]), and, second, whether the tax "may impair federal uniformity in an area where federal uniformity is essential"

(*Id.*, at p. 448 [60 L.Ed.2d at p. 347]), and prevents "the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.' If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause." (*Id.*, at p. 451 [60 L.Ed.2d at p. 349], quoting Michelin Tire Corp. v. Wages (1976) 423 U.S. 276, 285 [46 L.Ed.2d 495, 503]; *Container, supra*, 463 U.S. at pp. 193-194 [77 L.Ed.2d at p. 571].)

The court in *Japan Line* assumed, without deciding, that the tax at issue passed constitutional muster under the four-part interstate test, and proceeded to ask the two new questions. (441 U.S. at p. 451 [60 L.Ed.2d at p. 349].)

The court had little difficulty in determining that California's property tax failed the first additional test: since the facts showed that Japan taxed the cargo containers at full value, California's tax created more than the risk of multiple taxation; it in fact produced such taxation. (*Japan Line, supra*, 441 U.S. at pp. 451-452 [60 L.Ed.2d at pp. 349-350].)

The court decided rather easily that California's tax prevented the nation from "speaking with one voice" in regulating foreign trade. (*Japan Line, supra*, 441 U.S. at pp. 452-453 [60 L.Ed.2d at pp. 350-351].) The court cited the Customs Convention on Containers, which both the United States and Japan had signed, and stated it reflected a national policy to remove all duties and taxes as to temporarily-imported containers in international traffic. (*Id.*, at pp. 452-453 [60 L.Ed.2d at pp. 350-351].) Since American-owned containers are not taxed in Japan, California's tax creates an asymmetry in international taxation operating to Japan's disadvantage; under such circumstances, the risk of retaliation by Japan is acute, a retaliation that of necessity would be borne by the entire nation. Finally, if other states were to follow California's example, taxation would vary port-by-port, making speaking with one voice impossible. (*Id.*, at p. 453 [60 L.Ed.2d at pp. 350-351].)

The relative ease with which these constitutional invalidations were made is grounded in the *Japan Line* court's sensitivity to intrusions by individual states into the realm of foreign affairs.

(See also Hines v. Davidowitz (1941) 312 U.S. 52, 63 [85 L.Ed. 581, 584-585]; United States v. Belmont (1937) 301 U.S. 324, 330-331 [81 L.Ed. 1134, 1139].) As to the first inquiry, the court noted that "[e]ven a slight overlapping of tax — a problem that might be deemed de minimis in a domestic context — assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." (Fn. omitted; *Japan Line, supra*, 441 U.S. at p. 456 [60 L.Ed.2d at p. 352].) When confronted with the assertion that it was Japan's levy rather than California's which created the double tax, the court responded, "California's tax, however, must be evaluated in the *realistic framework of the custom of nations* . . . ." (Emphasis added, *id.*, at p. 454 [60 L.Ed.2d at p. 351].)

Regarding the second inquiry, the court stressed that the foreign commerce power of Congress is greater than its interstate commerce power, and emphasized not only the need for uniformity in dealing with other nations but "the Framers' overriding concern that 'the Federal Government must speak with one voice when regulating commercial relations with foreign governments.' " (*Japan Line, supra*, 441 U.S. at pp. 448-449 [60 L.Ed.2d at pp. 347-348].) Of course *Japan Line* involved a property tax on a foreign cargo container, not a particular method of income tax allocation applied to a foreign-based unitary group.

The case of Container Corp. v. Franchise Tax Bd. supra, 463 U.S. 159 [77 L.Ed.2d 545], to which we turn now, involved not only a particular income tax method but the one at issue here.

Container held in part that California's application of WWCR to domestic-based unitary groups was constitutional under the dormant foreign commerce clause test enunciated in *Japan Line*. (463 U.S. at pp. 185-197 [77 L.Ed.2d at pp. 566-573].) Container Corporation was a business entity incorporated in Delaware and headquartered in Illinois with 20 subsidiaries in 4 European and 4 Latin American countries. (*Id.*, at pp. 163, 171 [77 L.Ed.2d at pp. 551, 557].)

At the outset of its foreign commerce clause discussion, the court in *Container* stated that "[t]he case most relevant to our inquiry is *Japan Line*." (463 U.S. at p. 185 [77 L.Ed.2d at

p. 566].) Following *Japan Line*, *Container* applied the two additional foreign commerce clause considerations there set forth. (463 U.S. at pp. 185-186 [77 L.Ed.2d at pp. 566-567].)

Before applying those two additional considerations, *Container* noted the similarities and differences between the two cases. Similarities included the fact that actual double taxation had resulted, that such taxation stemmed from a serious divergence between California and foreign taxing methods, that the foreign taxing method was consistent with international practice (i.e., AL/SA), and that "our own Federal Government, to the degree it has spoken, seems to prefer the taxing method adopted by the international community to the taxing method adopted by California." (Fn. omitted, 463 U.S. at pp. 184, 187 [77 L.Ed.2d at pp. 565, 567].)

Three differences were noted. First, the tax in *Container* was on income rather than on property, and the court noted the ease with which income traverses boundaries. Second, the double taxation, although real, was not the " 'inevitabl[e]' result of the California taxing scheme." Finally, the tax in *Container* fell, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States. (463 U.S. at pp. 187-188 [77 L.Ed.2d at pp. 567-568].) After essentially analogizing a corporation and an instrumentality of commerce, *Container* carefully noted "[w]e have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." (*Id.*, at p. 189, including fn. 26 [77 L.Ed.2d at p. 568].) It is important to note at this juncture that those issues are the crux of the matter presented here.

In applying the first additional test set forth in *Japan Line*, *Container* noted *Japan Line*'s concern that even slight overlapping of tax assumes importance in the sensitive area of foreign relations, but further noted that this concern did not express an absolute prohibition on stated-induced double taxation. While such taxation deserves close scrutiny, said *Container*, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to

the taxing state. (463 U.S. at p. 189, [77 L.Ed.2d at pp. 568-569].) Taking into account the context of the tax, the distinction between an income tax and a property tax, and the fact that even implementing AL/SA would not guarantee an end to double taxation, *Container* concluded that since California's taxing method did not "inevitably" lead to double taxation, it would be perverse to constitutionally require one method of taxation over another when both could result in a double tax. (*Id.*, at pp. 189-193 [77 L.Ed.2d at pp. 568-571].)

Proceeding to *Japan Line*'s second inquiry — that is, the "one-voice" standard — *Container* stated: "In conducting this inquiry, . . . we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.' [Citations.] Thus, a state tax at variance with federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive [the second of these considerations being essentially a preemption analysis]." (Emphasis in original, 463 U.S. at p. 194 [77 L.Ed.2d at pp. 571-572].)

In applying this refinement of the one-voice standard, *Container* noted that the most obvious foreign policy implication of a state tax is the threat it might pose of offending foreign trading partners and leading them to retaliate against the nation as a whole. *Container*, however, said the judiciary has little competence in making these determinations on a theoretical basis, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the states tax as they please. (463 U.S. at p. 194 [77 L.Ed.2d at p. 572].) The *Container* court emphasized that the nuances of foreign policy "are much more the province of the Executive Branch and Congress than of this Court." (*Id.*, at p. 196 [77 L.Ed.2d at p. 573].) According to *Container*, the best a court can do is try to develop objective standards that reflect general observations about international trade and relations. (*Id.*, at p. 194 [77 L.Ed.2d at p. 572].)

Container provided three reasons that weighed strongly against the possibility of justifiable and significant foreign retaliation. First, California's taxing method as applied to domestic-based unitary groups did not create an "*automatic* 'asymmetry'" in international taxation operating to a foreign entity's disadvantage. (Emphasis in original, 463 U.S. at pp. 194-195 [77 L.Ed.2d at p. 572].) Second, the method was imposed not on a foreign entity, as was the case in *Japan Line*, but on a domestic corporation. At this point, the *Container* court noted that a tax falling on a domestic corporation "might be less significant in the case of a domestic corporation that was owned by foreign interests," that is, the court again noted it was not dealing with the issue presented here. (*Id.*, at p. 195, including fn. 32 [77 L.Ed.2d at p. 572].) Third, even if foreign nations had a legitimate interest in reducing the tax burden of domestic corporations, that burden is more the function of tax rate than of allocation method, and California can simply raise its rate to achieve the same foreign economic effect. (*Ibid.*)

After stating that the threat of retaliation was not the only foreign policy implication a state tax may have, the *Container* court noted there was no amicus curiae brief from the executive branch opposing the tax (463 U.S. at p. 195 [77 L.Ed.2d at pp. 572-573]), and indicated that although the lack of such a brief was not dispositive, it did suggest that United States foreign policy was not seriously threatened by California's application of WWCR to domestic-based corporate groups. (*Id.*, at pp. 195-196 [77 L.Ed.2d at p. 573].)

After concluding that foreign affairs were not implicated by California's unitary tax in a domestic-based multinational context, the *Container* court inquired whether the tax violated a "clear federal directive." For the following reasons, no such directive was found.

There was no federal statute on point. While there were numerous tax treaties that committed the federal government to use an arm's length method in taxing the domestic income of multinational enterprises, that requirement was generally waived as to contracting nations taxing their own domestic corporations. This fact, if nothing else said the *Container* court, "confirms our

view that such taxation is in reality of local rather than international concern." (463 U.S. at p. 196 [77 L.Ed.2d at p. 573].) Those tax treaties did not generally cover the taxing activities of states, and in none of them did the requirement of arm's length accounting apply to the states. Moreover, the United States Senate had on one occasion declined to give its two-thirds consent to a treaty provision that would have prohibited the states from using WWCR. Finally, the court noted that Congress had long debated but not enacted legislation designed to regulate state taxation of income. In light of these circumstances, the court in *Container* could not conclude that California's unitary tax method, as applied to domestic-based unitary groups, was pre-empted by federal law or fatally inconsistent with federal policy. (463 U.S. at pp. 196-197 [77 L.Ed.2d at p. 573].)

Unlike *Japan Line* and *Container*, the United States Supreme Court in Wardair Canada v. Florida Dept. of Revenue, supra, 477 U.S. 1 [91 L.Ed.2d 1], did not engage in a dormant commerce clause analysis, finding it "abundantly clear" that the federal government had affirmatively acted rather than remained silent with respect to the issue there: the power of a state to tax all airline aviation fuel sold within the state regardless of the airliner's destination or the amount of intrastate business it did. (Pp. 9, 12 [91 L.Ed.2d at pp. 10, 12].)

In *Wardair*, the airliner and the United States as amicus curiae argued there was a federal policy prohibiting such an unlimited tax, a policy manifested by (1) the 1944 Chicago Convention on International Civil Aviation (1944 Convention), which the United States had signed; (2) a 1966 Resolution of the International Civil Aviation Organization (1966 Resolution), an organization to which the United States belonged; and (3) more than 70 bilateral aviation agreements, including the 1974 US-Canadian Aviation Agreement (Agreement). (Wardair was a Canadian airline.) The court in *Wardair* saw things much differently. Not only did this evidence fail to reveal any such policy, said the court, but showed the federal government had affirmatively acted to permit the tax at issue, thus precluding application of the dormant foreign commerce clause test enunciated in *Japan Line*. (477 U.S. at pp. 8-12 [91 L.Ed.2d at pp. 9-12].)

Wardair's analysis proceeded as follows. The 1944 Convention only prohibited the local taxation of aviation fuel " 'on board an aircraft . . . on arrival . . . and retained on board on leaving.' " (477 U.S. at p. 10 [91 L.Ed.2d at p. 11].) That provision, said the court, demonstrated the international community's awareness of the problem of state taxation of aviation fuel, and represented a decision by the Convention parties to address the problem by limiting only some of the localities' power to tax while implicitly preserving other aspects of that authority. (*Ibid.*) While the 1966 Resolution undeniably endorsed an international scheme to exempt fuel tax " ' "from all customs and other duties," ' " neither the executive nor the legislative branch had acted in any way to give the Resolution the force of law. (*Id.*, at pp. 10-11 [91 L.Ed.2d at p. 11].) And after the Convention came into force, the United States entered more than 70 bilateral aviation agreements, not one of which prohibited the states from imposing a tax like Florida's. (*Id.*, at p. 11 [91 L.Ed.2d at pp. 11-12].) The US-Canadian Agreement itself was limited to " 'national duties and charges,' " an especially striking feature given that (1) the Agreement was completed eight years after the 1966 Resolution specifically addressed the concern of subnational taxation, and (2) both signatories were federalist nations. (*Id.*, at pp. 11-12 [91 L.Ed.2d at pp. 12].) Moreover, throughout the duration of the Agreement, other American states and some Canadian provinces had imposed fuel taxes similar to Florida's without challenge, a course of conduct suggesting that the parties to the Agreement and those most immediately affected by it understood it to permit this taxation. (477 U.S. at p. 12 [91 L.Ed.2d at pp. 12].)

"What all of this makes abundantly clear," said the court in *Wardair*, is that the federal government has not remained silent but "[b]y negative implication" "has at least acquiesced" in the state taxation at issue. (477 U.S. at p. 12 [91 L.Ed.2d at pp. 12].) The dormant commerce clause test of *Japan Line* was deemed inapplicable because "the Federal Government ha[d] affirmatively decided to permit the States to impose these sales taxes on aviation fuel." (*Ibid.*)

Notable is the fact that the *Wardair* court continually reaffirmed the foreign dormant commerce clause test created in

Japan Line, but failed to find an opportunity to employ it. Also notable is *Wardair's* recognition of the basic value underlying that clause: to "ensure that the essential attributes of nationhood will not be jeopardized by States acting as independent economic actors." (477 U.S. at p. 12; see also pp. 7-8 [91 L.Ed.2d at p. 12].) And the heightened importance of this value in the context of foreign commerce was recognized by *Wardair* when it stated: "In the unique context of . . . foreign commerce, we have alluded to the special need for federal uniformity: ' "In international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power" ' [quoting *Japan Line, supra*, 441 U.S. at p. 448 [60 L.Ed.2d 336], quoting Board of Trustees v. United States (1933) 289 U.S. 48, 59 [77 L.Ed. 1025]." (477 U.S. at p. 8 [91 L.Ed.2d at p. 9].)

With the various holdings and analysis of the problems decided in *Japan Line, Container*, and *Wardair* in mind, we turn to the present context. The first issue to be resolved is whether the Board is correct that our case tracks *Wardair*, rendering a dormant commerce clause analysis unnecessary. For the reasons that follow, we think the Board is incorrect in its conclusion.

Preliminary, we reject the Board's suggestion that the three decisions, *Japan Line, Container*, and *Wardair*, together manifest a significant retrenchment in the sensitivity shown to foreign relations. Both *Container* and *Wardair* reaffirmed *Japan Line's* sensitivity to the unique context of foreign commerce and the special need for federal uniformity in international relations. To us, the theoretical underpinning has remained intact through these cases. What was different in them was the degree to which foreign affairs and international commercial relations were implicated. In *Japan Line*, the factual context presented an international asymmetry, an acute risk of retaliation, and varying degrees of international multiple taxation. By contrast, in *Container*, there was a minimal risk of retaliation, a largely domestic context, and executive branch silence; and in *Wardair*, both the American government and the Canadian government (the foreign country involved) had essentially agreed to permit the subnational taxation at issue. Far from demonstrating any significant retrench-

ment in the sensitivity shown to foreign relations, the three cases demonstrate how that sensitivity is aligned with the degree to which such relations are implicated.

Relying upon five perceived indications of executive and congressional acquiescence in light of the principles of *Wardair*, the Board contends an affirmative federal policy permitted California's use of WWCR. Those five factors are (1) the failure to consider state taxes in United States income tax treaties with foreign countries, except in nondiscrimination clauses; (2) the actions by the executive branch in adopting a Model Income Tax Treaty and in reserving its position on the Organization of Economic Cooperation and Development (OECD) Model Convention's application to subnational taxes; (3) Friendship, Commerce, and Navigation (FCN) Treaties to which the United States is a party do not require the states to use any particular method of tax accounting; (4) the absence of enacted congressional legislation prohibiting or restricting the states' use of WWCR; and (5) the rejection by the United States Senate of article 9(4) in the United States-United Kingdom Tax Treaty, the only attempt by the executive branch to alter federal acquiescence in the states' use of WWCR.

In analyzing the treaties and treaty actions encompassed in factor (1) through (3), we find little, if any, support for the Board's position. True, these treaties and actions reflect a *general* policy at the federal level of noninterference in state taxation, but they do so to preserve the *general* principle of state sovereignty. Not one of the treaties or actions, except for the U.S.-U.K. Tax Treaty to which we shall come, specifically addresses the unitary tax method or the use of WWCR by subnational units. The treaties either state in general terms that they apply to national taxes, or contain general provisions regarding subnational taxes. The reservations were made to model treaty provisions that state generally that the treaties should apply to subnational taxes. Moreover, it was not until the 1970's when use of WWCR in an international context essentially began that a problem of international dimension arose. (Cal. Code Regs., tit. 18, § 25137-6; see Comment, *California's Corporate Franchise Tax: Taxation of Foreign Source Income?* (1980) 20 Santa Clara L. Rev. 123,

131-136; hereafter 20 Santa Clara L.Rev.) Many of the treaties predate the existence of the problem and therefore do not discuss it.[4]

[4]The Board chides the trial court for determining that pre-1978 tax treaties were largely irrelevant to this case. To support its position, the Board cites the 1924 United States Supreme Court decision in Bass, Ratcliff & Gretton v. State Tax Commission, 266 U.S. 271 [69 L.Ed. 282]. In *Bass*, the court constitutionally validated New York's application of a unitary business/formula apportionment method to the overall income of a British brewing company that imported a portion of its product through branch offices in New York and Chicago. Because of *Bass*, says the Board, the international community has been well aware since 1924 of this income allocation alternative to the AL/SA method.

Rather than support the Board's argument, we think *Bass* undermines it. Awareness of a particular tax theory is one thing; to be subjected to that theory in practice is quite another. Though *Bass* and its foreign-based unitary tax concept have been around since 1924, it was not until the early 1970's when the concept began to be noticeably *applied* that the problem of unitary taxation in the international arena arose. That history supports the idea that such a tax, though known as a concept, was little applied in international practice and thus largely irrelevant beyond our borders. (See Mobil Oil Corp. v. Commissioner of Taxes (1980) 445 U.S. 425, 438-439, 446-448 [63 L.Ed.2d 510]; *Container, supra*, 463 U.S. at pp. 163-165, 168-169, including fn. 7, 185-197 [77 L.Ed.2d 545].) All of this supports the trial court's eminently sensible determination that a tax treaty cannot be relevant to a tax problem that did not exist and was not foreseeable at the time the treaty was negotiated. Like judicial decisions, the older tax treaties here cannot sensibly be considered authority for propositions not considered.

In a somewhat related vein, the Board also cites *Bass* as constitutionally validating the unitary tax method as applied to foreign-based corporations. For a number of reasons, we disagree. First, *Bass* was decided before the United States developed its network of international tax treaties. (See 23 Columbia Journal at p. 450, fn. 32.) Second, *Bass* did not discuss foreign policy implications. Third, *Bass* obviously did not have the opportunity to apply the foreign dormant commerce clause test as enunciated in *Japan Line*. Finally and most importantly, *Container* cited *Bass* three times in passing yet twice explicitly reserved determining the constitutionality of the unitary tax method as applied to foreign-based corporate groups. (*Container, supra*, 463 U.S. at pp. 164-166, 189,

Contrast the treaty analysis in *Wardair*. There, the specific subject matter encompassing the tax at issue, as well as inextricably related taxes, had been discussed in the 1944 international Convention well before the aviation agreements were negotiated. Many of these agreements also postdated the 1966 international Resolution which specifically discussed the subject matter encompassing the tax. The American government and the international community were therefore negotiating these agreements with a keen awareness of the tax involved in *Wardair*. In fact, *Wardair* involved an issue of subnational taxation and the most relevant agreement in that case — the United States-Canadian Agreement — was signed by two federalist nations 30 years after the 1944 Convention and 8 years after the 1966 Resolution; furthermore, the course of conduct under this agreement indicated the tax at issue was permitted.

The Board's approach is simply too general and ignores historical context in essentially arguing that when a treaty is limited to national taxes or fails to discuss a particular taxation method, a conscious decision has been made to allow states to tax in *any* manner they please. Common sense charts a different course while respecting the broad power of a state to tax. (See Hines v. Davidowitz, supra, 312 U.S. at p. 68 [85 L.Ed. at pp. 587-588].)

In an attempt to be more specific, the Board does note that many of the bilateral tax treaties contain nondiscrimination clauses applicable to the states. The Board argues that these clauses give rise to a *Wardair*-like "negative implication" of a decision by the treaty parties to resolve the problem of state taxation by curtailing only some of the states' power to tax, while implicitly preserving other aspects of that authority. (*Wardair, supra*, 477 U.S. at pp. 10, 12 [91 L.Ed.2d at pp. 11, 12].) Again, we disagree.

In *Wardair*, the negative implication arose because foundation agreements had addressed not only the specific subject matter encompassing the tax at issue but specific taxes within that

fn. 26, 195, fn. 32 [77 L.Ed.2d 545].) *Bass*'s importance fades considerably in light of these factors. (See 20 Santa Clara L.Rev. at pp. 126-128.)

subject, without addressing the tax at issue. Subsequent agreements were negotiated and conducted in the atmosphere of these foundational ones. The nondiscrimination clauses do not provide a similar parallel here. Those clauses are simply reflections of a general principle that a state shall not tax a foreign company more than it taxes its own companies. A *Wardair*-like negative implication concerning WWCR which arises from this generality is impossible.[5]

Also cloaked in generality is the Board's fourth factor that the Board asserts would preclude a dormant commerce clause analysis: the absence of enacted congressional legislation prohibiting or restricting the use of WWCR to foreign-based multinationals.

Apparently the Board concedes the trial court's finding that there was no evidence there has ever been a vote in a congressional committee or in Congress itself on legislation prohibiting the use of WWCR. And the senior career official in the Department of Treasury for WWCR matters during much of the 1970's and 1980's, George N. Carlson, testified that none of the proposed legislation dealt solely with WWCR as to foreign-based enterprises. It is also true, as reiterated in *Container*, that " 'Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income.' " (463 U.S. at pp. 196-197 [77 L.Ed.2d at p. 573], quoting Mobil Oil Corp. v. Commissioner of Taxes, supra, 445 U.S. at p. 448 [63 L.Ed.2d at p. 528].)

The problem with this factor is that in trying to assign a specific reason to legislative inaction, we must enter the realm of pure speculation. It is difficult enough trying to ascertain legislative intent when a statute has been enacted, but trying to find meaning in legislative silence is about as difficult as hearing sound in a vacuum.

That brings us to the Board's fifth factor and the only one that specifically concerns the application of WWCR to foreign-based enterprises.

[5]Our determination is supported by the fact that less tax-specific treaties such as the FCN Treaties contain a comparable nondiscrimination clause. (23 Columbia Journal at p. 471.)

In 1975 the executive branch negotiated an income tax treaty with the United Kingdom containing a provision — article 9(4) — that would have prohibited the states' application of WWCR to U.K.-based corporate groups. The United States Senate ratified the treaty only after article 9(4) was effectively removed through a reservation by Senator Church. The Board contends this senatorial action "was a significant indication of federal policy to let the states continue to use WWCR." Again, the Board simply reads too much into too little.

The Church reservation to article 9(4) was defeated in the Senate Foreign Relations Committee and again on the Senate floor. However, the treaty with article 9(4) included received a favorable full Senate vote of only 49 to 32, falling 5 votes short of the two-thirds majority needed for ratification. When the Church reservation was resurrected without a vote and the controversial article was effectively removed, the Senate then provided its constitutional imprimatur.

In light of these Senate tallies, it is difficult to see a congressional policy permitting states to use WWCR. Moreover, it appears that some of the senatorial opposition to article 9(4) was rooted not in the substance of the article but in the procedural wariness of addressing the problem through patchwork treaties rather than through comprehensive legislation.

The Board asks reasonably why no tax treaty subsequent to the U.S.-U.K. Tax Treaty has included a provision similar to article 9(4). The Board's answer is that the Senate action on 9(4) indicated a congressional policy permitting states to use WWCR. Our answer is that the constitutional high hurdle of treaty ratification and a treaty's piecemeal approach to the problem render a resolution via the treaty process ineffectual. We simply fail to see how three majority votes in the Senate essentially approving article 9(4) can be transmogrified into a *congressional policy* of disapproval.

Whether the Board's five factors are analyzed individually or collectively, they fall far short of establishing under *Wardair* an affirmative federal policy permitting California's use of WWCR. To the court in *Wardair* the factors there — an international

Convention, an international Resolution, and more than 70 post-Convention agreements, including the U.S.-Canadian Agreement and the course of conduct thereunder by its two federalist signatories — made it "abundantly clear" that the federal government had "affirmatively decided to permit the States to impose these sales taxes on aviation fuel." (477 U.S. at pp. 9-12 [91 L.Ed.2d at pp. 10-12].) That clarity was grounded in the close connection between those factors and the tax at issue, as the factors specifically discussed the subject matter of and taxes inextricably related to the tax at issue, or actually encompassed the type of tax at issue.

As we have seen, there is no similar connection between the factors cited by the Board and the WWCR taxation method at issue here. Only one of the Board's factors specifically addresses WWCR, and it does so in a manner that is at best neutral in respect to the Board's position. Interestingly, the court in *Container* had before it many of the same factors upon which the Board relies including the Senate action on the U.S.-U.K Treaty, and nevertheless engaged in a dormant commerce clause analysis. (463 U.S. at pp. 185-197 [77 L.Ed.2d at pp. 566-573].) Put most succinctly, while the court in *Wardair* was dealing with hard and specific evidence, we have been dealt "Five Easy Pieces." We proceed to a foreign dormant commerce clause analysis, applying the foreign dormant commerce clause test of *Japan Line* and *Container*.

1. *The Enhanced Risk of Multiple Taxation.*

This consideration need not detain us long. All of the elements of double taxation involved in *Container* are also involved here. (463 U.S. at pp. 189-193 [77 L.Ed.2d at pp. 568-571].) But *Container* rejected those elements, reasoning that they were not "inevitable" and that resorting to the AL/SA method would not guarantee their demise. (*Ibid.*) We can discern no constitutionally significant differences between domestic-based and foreign-based multinational corporations concerning the enhanced risk of multiple taxation: in neither case is double taxation inevitable. Following the precedent of *Container*, we find California's use of

WWCR as to foreign-based multinationals is not unconstitutional on this ground.

2. *Whether California's Application of WWCR to Foreign-Based Unitary Groups May Impair Federal Uniformity in an Area Where Federal Uniformity Is Essential and Prevents the Federal Government From Speaking With One Voice in International Trade.*

A. Foreign Policy Implications

The first issue to consider is whether California's application of WWCR to foreign-based unitary groups implicates foreign policy issues which must be left to the federal government. (*Container, supra*, 463 U.S. at p. 194 [77 L.Ed.2d at pp. 571-572]; see also *Japan Line, supra*, 441 U.S. at pp. 448, 453 [60 L.Ed.2d at pp. 347, 350].) We think that it does.

According to *Container*, "[t]he most obvious foreign policy implication of a state tax is the *threat it might pose* of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." (Emphasis added, 463 U.S. at p. 194 [77 L.Ed.2d at p. 572].) Every single nation in the industrialized western world has sent letters to the United States government protesting the use of WWCR by American states. Many of these protests have also been directed to California. Among the most vigorous of these remonstrators has been Canada, by far the United States's largest trading partner, and Britain, this country's largest foreign investor. These protests have been sharp, frequent, and incessant over a number of years. There was also evidence that no other taxation issue had ever led foreign governments to deal directly with American states. Even high-placed officials of the Board acknowledged awareness of this international outcry. (See 20 Santa Clara L.Rev. at pp. 125-126.)

And it is not just talk. The ultimate test of diplomatic sincerity — watch what they do, not what they say — has been met here. In 1985, Britain passed retaliatory legislation withdrawing a tax advantage for U.S.-based corporations doing business in both Britain and a unitary tax state. Though Britain stopped short of pulling the procedural trigger to fully implement this legislation,

the law had a retroactive provision that impelled many American companies into preimplementation compliance. Moreover, Britain cancelled a trade mission to Florida because that state applied WWCR to foreign-based multinationals. And there were other similar cancellations. There was also evidence the United States has had problems in negotiating treaties because of objections to WWCR.

The Board claims Britain has orchestrated the international outcry and passed a disingenuous piece of "retaliatory" legislation that does not retaliate. However, some nation has to take the lead and the often-noted "special relationship" between Britain and the United States makes Britain the obvious choice for conductor. We doubt that every industrialized country in the western world would have joined the symphony if there were not truly a significant problem. In fact, a committed leader is more likely, not less likely, to be genuinely devoted. As to the allegedly devious legislation, Britain, the largest foreign investor in the United States, stood to lose disproportionately if America deemed that legislation completely unfounded. Many American companies operating in Britain did not believe such legislation was merely for show. Moreover, the legislation was introduced "back-bench," that is, by the opposition party, and nevertheless passed unanimously — extraordinary legislative feats according to the bill's author.

Our views are buttressed by analyzing the three general factors identified in *Container* that "might justifiably lead to significant foreign retaliation." (463 U.S. at pp. 194-195 [77 L.Ed.2d at p. 572].) The first factor is whether California's use of WWCR creates an automatic asymmetry in international taxation operating to the foreign-based multinational's disadvantage. Because no other country in the world uses WWCR, domestic-based multinationals do not face this taxation method abroad. And while both domestic and foreign-based multinationals are subjected to the method if they do business in an American jurisdiction that employs it, the administrative burdens of compliance, as we shall see, fall much harder on the foreigner.

The second general factor identified in *Container* inquires whether the legal incidence of the tax falls on a domestic

corporation or a foreign one. (463 U.S. at p. 195 [77 L.Ed.2d at p. 572].) This factor was of significant importance in *Container*, being noted at four places in the opinion. (*Id.*, at pp. 188-189, 195, including fns. 26, 32 [77 L.Ed.2d at pp. 568-569, 572].) We face here the precise issue reserved in *Container*: "the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." (*Id.*, at p. 189, fn. 26 [77 L.Ed.2d at p. 568].) *Container* carefully noted that the tax there was imposed on a domestic corporation, "not on a foreign entity as was the case in *Japan Line*," and that "[a]lthough, California 'counts' income arguably attributable to foreign corporations in calculating the taxable income of that domestic corporation, the legal incidence of the tax falls on the domestic corporation." (*Id.*, at p. 195 [77 L.Ed.2d at p. 572].) *Container* also recognized "that the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests." (463 U.S. at p. 195, fn. 32 [77 L.Ed.2d at p. 572].)

Here, California's taxation method of WWCR falls directly on a domestic corporation with a foreign parent (Barcal) and directly on a foreign corporation with a foreign parent and foreign subsidiaries (BBI). As we have seen, foreign governments are none too happy about this state of affairs. The governments of Britain and Canada have expressed their displeasure to this court through their amici curiae briefs.

Proponents of the worldwide unitary tax method cannot dispel foreigners' concerns by arguing that it is really the United States subsidiary or operation that bears the tax burden. The premise of the unitary tax system is that it is unrealistic geographically to isolate income derived from the intangible flow of value among the parts of a unitary business. Similarly, then, it is unrealistic to isolate the tax payments necessitated by that system: the incidence of taxation falls on the entire business, including the foreign parent. (See 23 Columbia Journal at p. 466.)

That brings us to the third general factor identified in *Container* as bearing on the risk of foreign retaliation: whether the tax

burden is more a function of California's WWCR tax rate or its allocation method. (463 U.S. at p. 195 [77 L.Ed.2d at p. 572].)

Foreign-based corporate groups incur significantly greater administrative costs to comply with California's WWCR system than do their domestic-based counterparts; in fact, all of the trial witnesses agreed that literal compliance with the system was cost-prohibitive for the foreign groups.[6] (See Comptroller General Report, *Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving*, 3, GAO/GGD-82-38 (1982) [hereafter, GAO Report].)

In a nutshell, this distinction between domestic and foreign-based multinationals is a result of the following: while domestic-based multinationals keep most of their records in English, in United States currency and in accord with United States accounting principles, the same cannot be said for multinationals based abroad. (GAO Report at p. 39.) For the foreign parent, some of the information may not be available because different nations use different accounting methods. Obviously, the information that does exist is not always in the language, in the currency, and in accord with the principles just noted. Substantial costs are incurred in obtaining the necessary information and translating and transforming it to these modes. (See 20 Santa Clara L.Rev. at pp. 143-144; 23 Columbia Journal at p. 471.)

The administrative nightmare for the foreign-based multinational is aptly demonstrated here. In 1977, BBI, a Britain-based company, was engaged in business directly or through subsidiaries in approximately 55 countries. During this time, BBI had an interest sufficient for California unitary group purposes, in more than 70 subsidiaries operating in approximately 34 countries outside Britain. Two of those subsidiaries were organized and operated in the United States: Barcal and Barclays Bank of New

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[6]The Board contends the trial court should have excluded all evidence on cost of compliance because plaintiffs failed to adequately raise the issue in administrative proceedings. We disagree. Plaintiffs' original and supplemental protests raise the compliance issue as part of their overall constitutional challenge. Moreover, the Board was apprised of this issue in correspondence during the administrative process.

York (BBNY). In addition to owning BBI and BBI's subsidiaries, BBL, the Britain-based ultimate corporate parent, owned a sufficient interest for California unitary purposes in over 140 subsidiaries that operated outside the United States. All told then, the Barclays unitary group consisted of over 220 subsidiaries (including subsidiaries of subsidiaries)operating in some 60 countries, but of these only BBI, Barcal, and BBNY, did business in the United States.

Using the Board's own figures, only 1.5 percent of the income generated by the Barclays group worldwide in 1977 can be attributed to California. Even accounting for the BBNY activity, this means that over 98 percent of the Barclays group's income in 1977 had its source outside the United States. According to witnesses at trial, it would cost millions of dollars for Barclays to establish and maintain the global system necessary to literally comply with California's WWCR tax method. (The figures ranged from $6.4 million to $7.7 million to establish the system, and from $2 million to $3.8 million a year to maintain it.) And note that Barclays, unlike many other foreign multinationals, at least speaks the same language as the California taxing authorities.

That it is California's allocation method rather than its tax rate that is the primary source of difficulty becomes readily apparent when these kinds of circumstances are viewed by foreign entities steeped in the AL/SA tradition. Foreign anger is even more understandable in light of the critical role the United States has played in attempting to construct a coherent and nondiscriminatory tax policy for all nations based on the AL/SA method. (See 23 Columbia Journal at pp. 459-462; 20 Santa Clara L.Rev. at pp. 153-154.)

The trial court deemed these costs of compliance sufficient to invalidate WWCR as an unconstitutional discrimination against foreign commerce — i.e., as a breach of one of the original four tests set forth in *Complete Auto* (430 U.S. 274 [51 L.Ed.2d 326]). While we do not here use costs alone to constitutionally invalidate the use of WWCR (see *Bibb v. Navajo Freight Lines* (1959) 359 U.S. 520, 526 [3 L.Ed.2d 1003, 1008]), this legal analysis by the trial court — based upon a factual foundation of

substantial evidence — demonstrates just how serious the administrative burden can be for the foreign entity.

The Board argues that literal compliance is a nonissue because regulations have been adopted by which a foreign-based multinational can use reasonable approximations to figure its California tax. (Cal. Code Regs., tit. 18, § 25137-6; Rev. & Tax Code, § 25137.) These approximations, according to the Board, can be derived from annual reports and other data that are already publicly available. (See 23 Columbia Journal at p. 472.)

There are several problems with the Board's argument. The Board decides whether to allow a foreign entity the route provided by regulation 25137-6, and such discretion is a powerful instrument in light of the cost-prohibitive alternative of literal compliance. Moreover, California state tax authorities have at least once threatened to impose penalties for failure to produce detailed information needed to apportion income, even though the British-based company involved claimed the information was confidential under Britain's national security laws. (See *EMI Ltd. v. Bennett* (N.D.Cal. 1982) 560 F.Supp. 134; *Capitol Industries — EMI, Inc. v. Bennett* (9th Cir. 1982) 681 F.2d 1107, 1110-1111; 23 Columbia Journal at p. 472.) These tax authorities cannot maintain on the one hand that reasonable approximations derived from already publicly available data are sufficient, and on the other hand demand under sanction more detailed information that is not readily available or even producible. Logically, detailed information on payroll, property, and sales is needed to apply the WWCR formula in an uncapricious manner. But more fundamental is why a state which has so little faith in the AL/SA method would so willingly embrace another method that is based on approximations derived from very general data? In light of these observations, the practical availability of the reasonable approximation approach is seriously open to question.

In contrast to *Container* then, we do not have to speculate on whether the taxation method at issue may offend our foreign trading partners and lead them to retaliate against the nation as a whole. (463 U.S. at p. 194 [77 L.Ed.2d at p. 572].) They are offended; they have retaliated. And the three general factors identified in *Container* that might justifiably lead to significant

retaliation — asymmetry, upon whom the tax falls, and tax rate versus allocation method — are all present in this case. (*Id.*, at pp. 194-195 [77 L.Ed.2d at p. 572].)

Also in marked contrast to *Container* stands the amicus curiae brief from the federal executive branch opposing California's application of WWCR to foreign-based corporate groups. That brief reiterates many of the points noted above and delineates an executive branch policy we will discuss below. We are mindful of *Container's* observation that in the context of the foreign commerce clause the foreign policy nuances of the United States are much more the province of the executive and the Legislature than of the judiciary. (463 U.S. at pp. 195-196 [77 L.Ed.2d at pp. 572-573].)

B. Clear Federal Directive

That brings us to the other avenue identified in *Container* by which a state tax will violate the "one-voice" standard: if the tax violates a clear federal directive. (463 U.S. at p. 194 [77 L.Ed.2d at pp. 571-572].) As this consideration is an integral component of the dormant commerce clause test, obviously such a directive is not synonymous with an affirmative federal policy precluding dormant commerce clause analysis. (*Id.*, at pp. 193-194 [77 L.Ed.2d at p. 571].)

In dealing with this issue, the court in *Container* looked for specific indications of congressional intent after noting that no amicus brief from the executive branch had been filed. (463 U.S. at pp. 195-196 [77 L.Ed.2d at pp. 572-573].) Examining much of the same evidence relied on by the Board here to preclude a dormant commerce clause analysis, *Container* did not find any such indications and concluded that California's application of WWCR to domestic-based corporate groups was not preempted by federal law or fatally inconsistent with federal policy. (*Id.*, at pp. 196-197 [77 L.Ed.2d at p. 573].)

Like the court in *Container*, the trial court in this instance found "no Congressional expression either way on this subject." Our earlier discussion as to why *Wardair* does not preclude a dormant commerce clause analysis supports this finding.

However, the trial court found the evidence unequivocal "that the executive branch all along, under three administrations since the WWCR problem in the present context became known, has steadfastly adhered to a policy of use of the arms length/separate accounting (AL/SA) method and not WWCR, both as to the States and the Federal Government." In the context presented here, we agree with the trial court.

George Carlson, who was the Treasury Department's (the executive department charged with formulating tax policy) senior career official for WWCR issues during most of the 1970's and 1980's, testified regarding the executive branch's policy on WWCR application to foreign-based corporate groups. That policy was officially pronounced in 1975 when the U.S.-U.K. Tax Treaty was signed, and essentially proscribed such an application while advocating an accounting restriction to the "water's-edge" of the United States. The genesis of the policy can be found in Treasury Department studies confirming complaints from foreign governments about increased risks of double taxation, disproportionate administrative burdens, and possible retaliation. Additionally, those studies found that WWCR in a foreign context was interfering with the federal government's foreign commercial policy and its ability to negotiate bilateral tax treaties. In short, the Treasury Department — again, the executive department charged with formulating the executive branch's tax policy — concluded that WWCR was an irritant in our foreign commerce relations.

This executive policy remained constant through four presidential administrations, starting when negotiations on the U.S.-U.K. Tax Treaty began, to the point when this case was litigated. And though there was a change in political party of the executive during this time, there was no change in policy: the executive branch did not want WWCR applied to foreign-based corporate groups.

Negotiations on the U.S.-U.K. Tax Treaty began during President Nixon's administration.

That treaty, with article 9(4) included, was signed during President Ford's tenure.

President Carter's Secretary of the Treasury, Michael Blumenthal, in a 1977 letter to Martin Huff, then the executive director of the Board, stated: "The unitary apportionment system is inconsistent with accepted tax treaty policy which prohibits one country from taxing the business profits of an enterprise of the other unless that enterprise is engaged in business through a permanent establishment in the first country.... [¶] ... The arm's length standard is the internationally accepted approach." And President Carter's Assistant Secretary of the Treasury for Tax Policy, Donald Lubick, explained the administration's position to both houses of Congress in March and June of 1980. Lubick emphasized that WWCR application to foreign-based corporate groups was the preeminent concern, citing the firmly-documented problems of foreign policy interference, double taxation, administrative burdens, and possible retaliation.

Faced with a deluge of complaints from all of our major trading partners and his patience exhausted by the failure of the states to resolve the WWCR problem voluntarily, President Reagan in 1985 publicly issued a directive on the matter. He instructed the Attorney General to pursue through litigation and the Secretary of the Treasury to pursue through legislation and where appropriate, through treaty amendment, the federal policy that multinational corporations be taxed by states only on income derived from the United States and not on income derived from foreign subsidiaries. Under the aegis of that directive, Secretary of State Schultz in early 1986 wrote to Governor Deukmejian urging him to support efforts to end California's use of WWCR. Not only did this letter explain that it was the long-standing policy of the United States to follow the AL/SA method, which was also the international standard, but that, "[y]our state's employment of the worldwide unitary method of tax accounting is at odds with the position of the United States and has become a source of conflict with foreign states;" furthermore, the letter pointed out that "[t]he worldwide unitary issue has seriously complicated our economic relations with many of our closest allies." California passed the "water's-edge" legislation a few months later.

On this record we feel confident in saying that the executive branch has spoken clearly. Through that branch, the policy of the

United States since the WWCR problem in the present context arose in the 1970's has been established: WWCR is not to be applied to foreign-based corporate groups — those groups are to be taxed by the states only on income derived from the United States.

Naturally, the question arises as to whether the executive branch alone can establish national policy in the field of foreign commerce or does it need the concurrence of the legislative branch?

Undoubtedly, the legislative branch can establish national policy in the field of foreign commerce without the concurrence of the executive branch. Specifically, the federal Constitution grants Congress this power (U.S. Const., art. I, § 8, cl. 3).

Does the same obtain for the executive branch? In the steel industry seizure case of Youngstown Sheet & Tube Co. v. Sawyer (1952) 343 U.S. 579 [96 L.Ed. 1153], Justice Jackson wrote a concurring opinion analyzing the scope of presidential power. (343 U.S. at pp. 634-656 [96 L.Ed. at pp. 1198-1210].) It has been said that Jackson's opinion "brings together as much combination of analysis and common sense as there is in this area, . . ." (See Dames & Moore v. Regan (1981) 453 U.S. 654, 661 [69 L.Ed.2d 918, 929].) In that opinion, Jackson set forth the following tripartite framework as a guide in resolving issues involving presidential power: "1. When the President acts pursuant to an express or implied authorization of Congress, his authority is at its maximum, for it includes all that he possesses in his own right plus all that Congress can delegate. In these circumstances, and in these only, may he be said (for what it may be worth) to personify the federal sovereignty.... A seizure executed by the President pursuant to an Act of Congress would be supported by the strongest of presumptions and the widest latitude of judicial interpretation, and the burden of persuasion would rest heavily upon any who might attack it. [¶] 2. When the President acts in absence of either a congressional grant or denial of authority, he can only rely upon his own independent powers, but there is a zone of twilight in which he and Congress may have concurrent authority, or in which its distribution is uncertain. Therefore, congressional inertia, indifference or quiescence may

sometimes, at least as a practical matter, enable, if not invite, measures on independent presidential responsibility. In this area, any actual test of power is likely to depend on the imperatives of events and contemporary imponderables rather than on abstract theories of law. [¶] 3. When the President takes measures incompatible with the expressed or implied will of Congress, his power is at its lowest ebb, for then he can rely only upon his own constitutional powers minus any constitutional powers of Congress over the matter. . . . Presidential claim to a power at once so conclusive and preclusive must be scrutinized with caution, for what is at stake is the equilibrium established by our constitutional system." (Fns. omitted, 343 U.S. at pp. 636-638 [96 L.Ed. at pp. 1199-1200].)

Based upon our previous analysis, the executive action here aligns with Justice Jackson's second category. And as noted by Justice Jackson, it is the imperative of events and contemporary imponderables rather than abstract theories of law that primarily guides our review.

We begin by emphasizing the field in which the executive branch has acted: foreign policy. That is a field in which the executive possesses substantial power of its own. (See United States v. Curtiss-Wright Export Corp., supra, 299 U.S. at pp. 319-320 [81 L.Ed. at pp. 262-263]; United States v. Belmont, supra, 301 U.S. 324 [81 L.Ed 1134]; United States v. Pink (1942) 315 U.S. 203 [86 L.Ed. 796]; *Container, supra*, 463 U.S. at pp. 165-166 [77 L.Ed.2d at p. 553]; U.S. Const., art. II, §§ 1, 2.) Although the Constitution grants to Congress the power to regulate commerce with foreign nations, the executive's rightful power in the foreign policy arena inextricably involves international commercial relations. *(Container, supra.)*

Particularly is this true in this era of increasingly "globalized" and rapidly changing economic forces, and the beginnings of economic displacement of military competition in big power relations. The rapidity with which global changes in economic structure are occurring places an imperative on the exercise of swift and effectual national power, the kind of power most suitably exercised by the executive. Recall *Wardair*'s reiteration that "'[i]n international relations and with respect to foreign

intercourse and trade the people of the United States act through a single government with unified and adequate national power.'" (477 U.S. at p. 8 [91 L.Ed.2d at p. 9], quoting *Japan Line, supra*, 441 U.S. at p. 448 [60 L.Ed.2d at p. 347], quoting Board of Trustees v. United States, supra, 289 U.S. at p. 59 [77 L.Ed. 1025].)

If Congress were to enact legislation or take some other affirmative action contrary to the executive branch policy, that would most likely be the end of the matter. But Congress must act as a consensual body before a legislative policy can be discerned. Before that happens, the legislative branch, in contrast to the executive branch, resembles more a cacophony than a chorus of voices, each legislator having his or her own reason for speaking. As detailed earlier, we discern no congressional policy regarding the states' use of WWCR.

We are mindful of the Board's concern about unbridled executive power and about national policy being nothing more than what the executive says it is. Again, however, we must emphasize that we are dealing with a critical foreign policy issue on which the executive has affirmatively acted and the Congress has not. Nor would it have been difficult for the Congress to act: one simple sentence in a piece of legislation, a treaty, or a resolution would have sufficed.

The evidence here reveals that as soon as the problem of WWCR in an international context arose, executive departments began studying the issue. Those studies confirmed the validity of the complaints from foreign governments and culminated in the official and public expression of executive branch policy in 1975 with the signing of the U.S.-U.K. Tax Treaty. In a nutshell, that policy sought the elimination of WWCR as applied to foreign-based corporate groups, and an accounting restriction to the "water's-edge" of the United States. The policy has never wavered though the party affiliations of the administrations continuing it have. In fact, through the years, the policy has grown stronger: the Reagan administration sought to eliminate WWCR as applied not only to foreign-based multinationals, but to domestic-based ones as well.

Public expressions of the executive policy have been made continuously since the mid-1970's. Even the executive director of the Board was explicitly informed by President Carter's Secretary of the Treasury in 1977 that the unitary apportionment system was inconsistent with accepted tax treaty policy — i.e., with the AL/SA method. And one cannot doubt the clarity of the executive's position.

In this context, it is unnecessary to fret about national policy being formulated through executive whim. Found here is a clear, continuous, and thoroughly-grounded policy developed by the executive branch in the face of congressional inertia and inaction, and directly involving an issue — foreign policy — to which great deference to the executive has traditionally been given. (See United States Curtiss-Wright Export Corp., supra, 299 U.S. at pp. 319-320 [81 L.Ed. at pp. 262-263]; Container Corp. v. Franchise Tax Bd., supra, 463 U.S. at pp. 195-196 [77 L.Ed.2d at pp. 572-573].) This context also strikes the proper balance between the purposes of the commerce clause — to avoid "economic balkanization," promote free trade and prevent individual states from working to the detriment of the nation as a whole — and the legitimate interest of the states in exercising their taxing power. (See Boston Stock Exchange v. State Tax Comm'n (1977) 429 U.S. 318, 328-329 [50 L.Ed.2d 514, 523-524]; National Meat Ass'n. v. Deukmejian (9th Cir. 1984) 743 F.2d 656, 659.) While we realize that a state's power to tax is bottomed on a broad base, we cannot ignore that California's application of WWCR to foreign-based corporate groups directly affects international relations. (See Hines v. Davidowitz, supra, 312 U.S. at p. 68 [85 L.Ed. at pp. 587-588]; Zschernig v. Miller (1968) 389 U.S. 429 [19 L.Ed.2d 683]; Bethlehem Steel Corp. v. Board of Commissioners (1969) 276 Cal.App.2d 221; Amarel v. Connell (1988) 202 Cal.App.3d 137.)

We must also emphasize that our determination has little to do with the technical merits of the WWCR method in the abstract. Theoretically, that method may very well be a superior one were it to be applied fairly by nations around the globe. But the international community is presently enmeshed in the tradition of separate accounting, a tradition largely engendered through American efforts. When an American state in isolation employs a method which radically departs from that tradition and which demands an accounting of foreign corporations that have nothing to do with the state or with the United States for that matter, the adverse implications for American foreign policy are not hard to imagine.

We hold that California's unitary tax method (worldwide combined reporting, WWCR) as applied to foreign-based unitary groups is unconstitutional under the foreign commerce clause of the federal Constitution because it not only implicates foreign policy issues which must be left to the federal government but violates a clear federal directive as well. (*Container, supra*, 463 U.S. at p. 194 [77 L.Ed.2d at p. 571].)

The Board argues that even if this application of WWCR is unconstitutional under the foreign commerce clause today, such a determination is irrelevant to its constitutionality in 1977. We disagree for two reasons.

First, we have determined the trial court was correct in finding that the executive branch since 1975 has clearly and consistently opposed applying WWCR to foreign-based corporate groups. Second, and more importantly, the "one-voice" standard of *Japan Line* and *Container* does not depend on the outcome of events for its application. In applying that test, the courts inquire whether a state tax "*may* impair federal uniformity in an area where federal uniformity is essential" (emphasis added, *Japan Line, supra*, 441 U.S. at p. 448 [60 L.Ed.2d at p. 347]); and they analyze "the *threat* [the tax] *might* pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole" by employing general standards to see if the tax "*might* justifiably lead to significant foreign retaliation." (Emphasis added, *Container, surpa*, 463 U.S. at p. 194 [77 L.Ed.2d at p. 572.) In short, the judiciary asks whether the probability of justifiable, adverse foreign response and actions is too strong to permit the state tax to stand. This judicial application of the foreign commerce clause thus aligns with the underlying premise of the clause: to "commit[ ] to the exclusive authority of the Federal Government the regulation of those aspects of foreign commerce that *by their very nature* 'necessitate a uniform national rule.' "

(Emphasis added, Wardair Canada v. Florida Dept. of Revenue, supra, 477 U.S. at p. 18 [91 L.Ed.2d at p. 16] [dis. opn. of Blackmun, J.], quoting *Japan Line, supra*, 441 U.S. at p. 449 [60 L.Ed.2d at p. 348].)

As the trial court aptly noted in this regard, "[t]his case factually demonstrates as extreme an example of predictable international consequences stemming from a local tax as can be conceived." Succinctly stated, the Board required the Britain-based Barclays group, which derived over 98 percent of its income from business activity outside the United States, to supply detailed accounting information on all of its more than 200 subsidiaries operating in some 60 countries because the group did a little over 1 percent of its business in California. In light of the custom of nations making AL/SA the international standard, the radical differences between AL/SA and WWCR, and the distinctions between this case and *Container*, a direct, adverse impact on foreign affairs was inevitable. The international furor that resulted was justified and therefore entirely predictable.

The Board unnecessarily worries whether such a holding would subject a state's power to tax to the mercy of a foreign government's vocal chords. Our opinion has made clear, substantially more than mere complaints are involved in this case. The essentials of the dilemma were concisely summarized by one witness at the U.S.-U.K. Tax Treaty hearings: "To permit them [the states] to roam the world threatening U.K. based companies having no permanent establishment in the U.S., demanding information which the U.S. would have no treaty right to demand, and generally acting like a bull in the international china shop, is unbecoming to the dignity of the U.S., to the placidity of its relations with those countries with which it solemnly negotiates treaties, and accomplishes no purpose necessary for the protection of the revenue of the taxing states." (23 Columbia Journal at p. 467.)

Having decided that California's application of WWCR (Rev. & Tax. Code, § 25101) to foreign-based unitary groups is unconstitutional under the foreign commerce clause of the federal Constitution, it is unnecessary for us to consider the plaintiffs' due process challenge.

The judgment is affirmed. *(CERTIFIED FOR PUBLICATION.)*

EVANS, J.*

We concur:

PUGLIA, P.J.

DAVIS, J.

* Assigned by the Chief Justice.

APPENDIX C

IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA

BARCLAYS BANK INTERNATIONAL, LTD.,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

BARCLAYS BANK OF CALIFORNIA,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

S019064
Ct. App. No. C003388
Sacto. Super. Ct.
Nos. 325059 and 352061

Supreme Court Filed May 11, 1992

Robert Wandruff Clerk
DEPUTY

We granted review to decide whether the use by the state Franchise Tax Board of a three-factor formula to apportion the income of a foreign-parent multicorporate unitary enterprise for state tax purposes violates the foreign commerce clause of the federal Constitution (art. I, § 8, cl. 3). We conclude that relevant treaty and other materials manifest a federal intent not to prohibit the states from employing formula apportionment in taxing the income of such a multinational unitary business. We therefore reverse the judgment of the Court of Appeal.

I

Plaintiff taxpayers, Barclays Bank of California and Barclays Bank International, Ltd. (collectively, the Bank), brought this refund action to recover assessments of $152,420 and $1,678 levied against them by the Franchise Tax Board (Board) for the 1977 tax year. The basis for the assessments was a finding by the Board that, together with their United Kingdom-based corporate parent and related worldwide subsidiaries, the Bank comprised a unitary enterprise, thereby subjecting it to the three-factor mathematical formula used by the Board to apportion the interjurisdictional income of a unitary business for state corporate income tax purposes.[1] Although the Bank did not contest the Board's predicate finding of corporate unity, it did claim that application of California's apportionment formula to such a unitary group — that is, one whose corporate parent is a foreign domiciliary — violates the foreign commerce clause of the federal Constitution.

Following a bench trial, the superior court ruled in favor of the Bank; the Court of Appeal affirmed, holding that California's

[1]During 1977, the tax year at issue here, Revenue and Taxation Code section 25101 provided in relevant part: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120 of this chapter); . . ."

Section 25120 et seq. of the Revenue and Taxation Code is California's version of the Uniform Division of Income for Tax Purposes Act (UDITPA; see 7A West's U. Laws Ann. (1985) p. 331); as explained more fully later in this opinion, the statute authorizes the use of a three-factor formula to apportion the net income from a taxpayer's total business activities in order to determine the net income attributable to intrastate activities. (See *post*, p. ___ et seq. [typed maj. opn. p. 5 et seq.]; Rev. & Tax. Code, §§ 25120-25140.)

In this opinion, we sometimes use the term "formula apportionment" as a shorthand description of this three-factor mathematical formula employed by the Board to apportion for state tax purposes the interjurisdictional income of a worldwide or domestic unitary enterprise.

formula apportionment method was unconstitutional as applied to foreign-based unitary groups. In the view of the Court of Appeal, use of the Board's method in such a case violated the foreign commerce clause in two respects. First, its application to a so-called "foreign parent" unitary business implicated foreign policy issues that were constitutionally required to be left to the federal government. Second, use of the formula apportionment method in the Bank's case was at odds with a clear federal directive embodied in presidential and cabinet-level statements, letters, and press releases, task force reports and the congressional testimony of senior executive officials to the effect that American foreign commercial policy supported the use of an alternative accounting method to determine the taxable income of foreign-based corporations, one that is incompatible with formula apportionment.

As the Court of Appeal recognized, this suit is not the first litigation challenging on foreign commerce clause grounds the Board's use of a three-factor formula to apportion the worldwide income of a multinational enterprise. In *Container Corp. v. Franchise Tax Bd.* (1983) 463 U.S. 159 (*Container*), the United States Supreme Court sustained against foreign commerce clause challenge the Board's use of formula apportionment to determine the taxable income of a *domestic*-based unitary business group with foreign-domiciled subsidiaries. Despite the outcome in *Container*, the Bank successfully contended before the Court of Appeal that issues implicated by its foreign parentage are dispositive of the constitutional question and compel the opposite result in this case.

Although presented with a question left open in *Container* (*supra*, 463 U.S. at p. 189, fns. 26 & 32), we approach its resolution along a path illuminated by the high court's analysis in a series of recent opinions, *Container* among them, in the contemporary evolution of the "dormant foreign commerce clause" doctrine. Our opinion has two parts. As a prelude to the constitutional question, we first examine the extralegal issues raised by competing methodologies used to distribute multijurisdictional corporate income for state tax purposes; we then address the Bank's central contention that a dormant foreign commerce clause analysis is appropriate here and that the Board's applica-

tion of formula apportionment to the Bank's unitary business does not survive that analysis.

As we explain, neither of the two competing models used to allocate interjurisdictional income for state tax purposes is demonstrably superior to the other, even in an international multicorporate setting. Both methods meet the constitutional standard of avoiding "unreasonably" attributing extrastate value to the taxing jurisdiction. Moreover, the high court's recent foreign commerce clause jurisprudence reflects a diminution in the reach of dormant foreign commerce clause analysis in favor of an expanded recognition that, under circumscribed conditions, governmental silence may constitute a ratification of state taxation of foreign commerce, rendering a dormant analysis inapposite. In our view, this is such a case.

II

Background: State Taxation of International Income

A

Limitations on taxation by the states of the income of corporations doing business in more than one jurisdiction inevitably implicate the sufficiency of quantitative measures used to identify that portion of taxable value reasonably attributable to the taxpayer's intrastate activities. This pivotal role of technique arises from the stricture of the commerce and due process clauses of the federal Constitution that "a State may not tax value earned outside its borders." (*ASARCO Inc. v. Idaho State Tax Comm'n* (1982) 458 U.S. 307, 315 (*ASARCO*).) To meet this limitation, state tax schemes must comply with multiple criteria designed to produce a substantially accurate distribution of income so that only "values created by business within its borders" are taxed. (*Butler Bros. v. McColgan* (1942) 315 U.S. 502, 507 (*Butler Bros.*).)

Two distinct models have long competed for supremacy in identifying the required division of multijurisdictional income. One model, known as the "arm's length/separate accounting" or "AL/SA" method, calculates income on a discrete and circum-

scribed basis, whether geographical, transactional, or functional. In a multicorporate interjurisdictional setting, the AL/SA method allocates income to a single taxing "sovereign" rather than apportioning it among jurisdictions, and treats intercorporate transfers of value between commonly held or related entities as if they were "arm's length" transactions between unaffiliated businesses. There seems little reason to doubt that, as an operational matter, the AL/SA model is the dominant method employed by corporations both in the United States and internationally; that is, a majority of businesses use the AL/SA or a variant method for their *own* internal accounting purposes.

The competing model for taxation purposes is the "unitary business/formula apportionment" method. Founded on the perception that "[i]n the case of a more-or-less integrated business enterprise operating in more than one State . . . arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice" (*Container, supra*, 463 U.S. at p. 164), formula apportionment relies on mathematical generalization to distribute an aliquot share of income or taxable value among taxing jurisdictions. The dominant variation of formula apportionment — the so-called "three-factor" model employed by the Board in this case — defines the multijurisdictional scope of the unitary enterprise of which the taxable intrastate activities are a part, calculates the combined income of the components of the unitary group, and distributes a portion of that result to the taxing state using a mathematical formula based on an averaged ratio of property, payroll, and sales in the taxing jurisdiction to that of the unitary enterprise overall.[2] (See *Container, supra*, 463 U.S. at p. 165.)

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[2]Thus, the taxable income of a multijurisdictional unitary taxpayer in a state using the three-factor variant of formula apportionment would be calculated under the following equation:

$$\frac{\dfrac{\text{In-state Property}}{\text{Total Property}} + \dfrac{\text{In-state Payroll}}{\text{Total Payroll}} + \dfrac{\text{In-state Sales}}{\text{Total Sales}}}{3} \times \begin{matrix}\text{Total}\\ \text{Corporate}\\ \text{Income}\end{matrix} = \begin{matrix}\text{Income}\\ \text{Taxable by}\\ \text{the state}\end{matrix}$$

So far as taxation of United States-derived income is concerned, the use of formula apportionment is both established and noncontroversial, being the preferred method of a majority of the states; a substantially smaller number of American jurisdictions — California among them — combine and apportion the *worldwide* income of multinational corporate taxpayers, a variant sometimes referred to as the "worldwide combined reporting" or "WWCR" method.[3]

Although AL/SA is the method of choice for corporate operational and internal accounting purposes, its recognized deficiencies in purporting to locate and assign taxable value to a particular jurisdiction reduce its appeal among state tax administrators, the chief proponents of competing apportionment methods. These critics cite several shortcomings in the AL/SA method: comparative distortions in measuring income, and a resulting overtaxation or undertaxation; administrative complexity generated by the need to analyze thousands of intercorporate transactions; and the common absence of uncontrolled comparable prices by which to verify the value of intercorporate "arm's length" transactions.[4]

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[3](See *Moorman Mfg. Co.* v. *Bair* (1978) 437 U.S. 267, 283, fn. 1 (Powell, J., dis.) [45 of 50 states use some form of income apportionment]; *Trinova Corp. v. Michigan Dept. of Treasury* (1991) ___ U.S. ___, ___ [111 S.Ct. 818, 831-832]; see also Chairman's Rep. and Supplemental Views, Final Rep. of the Worldwide Unitary Taxation Working Group (Aug. 1984) (hereafter Chairman's Report) p. 1 [all 45 states that levy a corporate income tax use formula apportionment to distribute taxable income of single multijurisdictional corporations]; U.S. General Accounting Office, Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving (July 1, 1982) GAO/GGD-82-38 (hereafter GAO Report), at appen. II, pp. 58-67 [tabular breakdown in use of apportionment variants among the states].)

[4]The critical literature assessing both methods is extensive. (For a sampling, see Chairman's Rep., *supra*; GAO Rep., *supra*; Note, *State Worldwide Unitary Taxation: The Foreign Parent Case* (1985) 23 Colum. J. Transnat'l L. 445; Comment, *California's Corporate Franchise Tax: Taxation of Foreign Source Income?* (1980) 20 Santa Clara L.Rev. 123; Rudy, *The California Unitary Tax Concept as

More fundamentally, critics of the AL/SA method have pointed to a theoretical failure of the model to account for income created by the effects of unitary interdependency. As the high court has stated in the case of a unitary business enterprise, "separate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. [Citation.] Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.'" (*Mobil Oil Corp. v. Commissioner of Taxes* (1980) 445 U.S. 425, 438 (*Mobil Oil*).)

Of course, formula apportionment has its critics, as well. They too point to distortions in the measurement of taxable income, especially in a multinational setting where a relatively larger proportion of foreign to United States activities may result in overtaxation of the income of foreign-based unitary businesses; the substantial administrative burden of complying with income reporting requirements in United States dollars and accessing financial information that in some cases may be in the hands of literally hundreds of worldwide corporate affiliates; and the absence of uniform standards among the states for defining a unitary

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Applied to the Worldwide Activities of Foreign Corporations: A Modern Commerce Clause Analysis (1980-81) 15 U.S.F. L.Rev. 371; Note, *Multinational Corporations and Income Allocation under Section 482 of the Internal Revenue Code* (1975-1976) 89 Harv.L.Rev. 1202; Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil, Exxon, and H.R. 5076* (1978) 79 Mich. L.Rev. 113; Hellerstein, *State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on ASARCO and Woolworth* (1982) 81 Mich. L.Rev. 157; Hellerstein, *State Taxation Under the Commerce Clause: An Historical Perspective* (1976) 29 Vand. L.Rev. 335; Corrigan, *Interstate Corporate Income Taxation — Recent Revolutions and a Modern Response* (1976) 29 Vand. L.Rev. 423; Langbein, *The Unitary Method and the Myth of Arm's Length* (1986) 30 Tax Notes 625; see also Hearings Before the House Com. on Ways and Means on H.R. No. 5076, 96th Cong., 2d Sess. (1980).)

business.[5] Not surprisingly, partisans on both sides of the issue contend that their method is the accepted standard — in the international arena in the case of AL/SA, and in the taxation of multijurisdictional unitary groups in the case of formula apportionment.[6]

B

The United States Supreme Court first considered the sufficiency of formula apportionment in the constitutional sense over 70 years ago, upholding Connecticut's use of a single-factor formula to apportion the income of a Connecticut business machine manufacturer whose products were marketed nationally. The high court rejected the taxpayer's due process claim that the formula taxed business conducted "beyond the boundaries of the State." As the Supreme Court explained, "[t]he profits of the [company are] largely earned by a series of transactions beginning with manufacture in Connecticut and ending with the sale in other states.... The legislature in attempting to put on this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." (*Underwood T'writer Co. v. Chamberlain* (1920) 254 U.S. 113, 120-121 (*Underwood*).)

Since *Underwood, supra*, 254 U.S. 113, the Supreme Court has confronted recurrent claims of the comparative superiority of each of these two theoretically irreconcilable techniques in responding to the distributive imperatives of the commerce clause. Despite claims of the surpassing merit of the separate accounting method, the court has refused to erect a "theoretical constitutional preference for one method of taxation over another" by mandating its use. (*Mobil Oil, supra*, 445 U.S. at p. 444.)

[5](See, e.g., Chairman's Rep., *supra*, at pp. 1-8; GAO Rep., *supra*, at pp. 32-40; and materials cited *ante*, at fn. 4.)

[6]The trial court found as a matter of fact that the AL/SA method was the "international standard of accounting" and that "[n]o other system is used internationally."

Likewise, it has rejected appeals to prescribe a variant of the formula apportionment method as a uniform national standard for interstate taxation. (*Moorman Mfg. Co. v. Bair, supra*, 437 U.S. 267, 278 (*Moorman*).)

Although the high court has refused to impose "national uniform rules for the division of income" rooted in the commerce clause (*Moorman, supra*, 437 U.S. at p. 279), it has repeatedly validated the comparative empirical accuracy and constitutional adequacy of formula apportionment. Thus, not long after upholding the due process sufficiency of formula apportionment in *Underwood, supra*, 254 U.S. 113, the court authorized its use in a multinational setting to apportion the combined income of a United Kingdom-headquartered brewer whose separate accounting showed no United States net income for the tax years at issue. Contending that the state was in effect taxing foreign income, the taxpayer asserted violations of the foreign commerce and due process clauses. (*Bass, Etc., Ltd. v. Tax Comm.* (1924) 266 U.S 271 (*Bass*).)

The high court rejected the challenge. The taxpayer's business, the court explained, was a unitary enterprise conducted transnationally, "in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places — the process of manufacturing resulting in no profits until it ends in sales. . . ." The state was thus justified "in attributing to [itself] a just proportion of the profits earned by the Company from such [a] unitary business." Moreover, since the taxpayer had failed, as in *Underwood, supra*, 254 U.S. 113, to show that formula apportionment "produced an unreasonable result," its use was not unconstitutional. (*Bass, supra*, 266 U.S. at pp. 282, 283.)

In *Butler Bros., supra*, 315 U.S. 502, the taxpayer also challenged the state's use of formula apportionment on the ground that separate accounting showed its sales office in the taxing jurisdiction had no net income for the tax year at issue and that apportionment thus resulted in the taxation of extraterritorial value. The court rejected this showing as insufficient, explaining that it "need not impeach the integrity of [the separate] accounting system to say that it does not prove [taxpayer's] assertion that

extraterritorial values are being taxed.... A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders." (*Id.*, at p. 507.)

And in *Exxon Corp. v. Wisconsin Dept. of Revenue* (1980) 447 U.S. 207, the court rejected the attempt of a vertically integrated, multistate petroleum company to demonstrate, based on its internal use of the separate accounting method applied to distinct operating divisions, that income was allocable to extrastate components and thus constitutionally was not subject to apportionment. "[A] company's internal accounting techniques are not binding on a State for tax purposes," the court wrote. "Exxon's use of separate functional accounting ... does not defeat the clear and sufficient nexus between [its] interstate activities and the taxing State" upon which the finding of corporate unity was based. [*Id.*, at pp. 221, 225.)

Again, in *Mobil Oil, supra*, 445 U.S. 425, a nondomiciliary corporate taxpayer challenged the state's inclusion in its apportionment formula of foreign source dividend income received by the taxpayer from subsidiaries and affiliates, on the ground that its foreign origin made it constitutionally unapportionable. Although the taxpayer was able to isolate its foreign dividend income using separate accounting, the court observed that "the linchpin of apportionability in the field of state income taxation is the unitary business principle." (*Id.*, at p. 439.) The divisibility of income produced by a separate accounting treatment, the court said, "may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.... Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required." (*Id.*, at p. 438.) (See also *ASARCO, supra*, 458 U.S. 307; *F. W. Woolworth Co. v. Taxation & Revenue Dept.* (1982) 458 U.S. 354; and *Amerada Hess Corp. v. N. J. Taxation Div.* (1989) 490 U.S. 66, 74.)

In a slightly different context, the high court recently reaffirmed its views of both the theoretical problems inherent in locating the "source" of multijurisdictional income, and the validity for commerce clause purposes of the formula apportion-

ment method. Last term, in upholding Michigan's "value added" tax against commerce clause challenge, the court wrote that "the discrete components of a state income tax may appear in isolation susceptible of geographic designation. Nevertheless, since *Underwood* ... we have recognized the impracticability of assuming that all income can be assigned to a single source." (*Trinova Corp. v. Michigan Dept. of Treasury, supra*, ____ U.S. ____, ____ [111 S.Ct. 818, 831].)

The court went on to reiterate its statement in *Container, supra*, 463 U.S. at page 170, that the three-factor formula "has become something of a benchmark against which other apportionment formulas are judged," noted its incorporation into UDITPA, adopted by almost half of the states, and acknowledged its accuracy in reflecting "the activities by which [taxable] value is generated." "The same factors," the court wrote, "that prevent determination of the geographic location where income is generated, factors such as functional integration, centralization of management, and economies of scale, make it impossible to determine the location of value added with exact precision." (*Trinova Corp. v. Michigan Dept. of Treasury, supra*, ____ U.S. ____ [111 S.Ct. at p. 832].)

Thus, the rule that has emerged from this series of high court encounters — spanning over 70 years — with the contending merits of two "theoretically incommensurate" systems (*Mobil Oil, supra*, 445 U.S. at p. 444) is that, for state tax purposes, neither the commerce clause nor the due process clause of the federal Constitution mandates the use of a particular methodology to allocate or distribute multijurisdictional income. Either of the two principal methods and their variants is constitutionally permissible, as long as the one chosen does not operate "unreasonably and arbitrarily" to attribute to the taxing state a percentage of total income "out of all appropriate proportion to the business transacted by the [taxpayer] in that State." (*Hans Rees' Sons v. No. Carolina* (1931) 283 U.S. 123, 135.) Or, as the high court stated in *Moorman, supra*, 437 U.S. 267, 274, "the States have wide latitude in the selection of apportionment formulas and ... a formula-produced assessment will only be disturbed when the taxpayer has proved by clear and cogent evidence that the income

attributed to the State is in fact out of all appropriate proportion to the business transacted . . . in that State." (Internal quotation marks omitted.)

We present this extended account of the competing division-of-income methods and their treatment at the hands of the high court in order to meet at the outset the Bank's unpersuasive contention that formula apportionment is an inherently inequitable method, at least when applied to foreign-based unitary groups such as the Bank and its affiliates.[7] In substance, this argument is no different from the one explicitly rejected by the court in *Container, supra*, 463 U.S. 159. There the taxpayer presented related challenges to California's use of the three-factor formula to apportion the global income of a domestic-based unitary enterprise. Specifically, the taxpayer claimed that its foreign affiliates were significantly more profitable, and that by ignoring underlying economic realities such as lower wage and production costs among its foreign subsidiaries, three-factor formula apportionment systematically distorted the "true" allocation of income between unitary components, unfairly inflating the income apportioned to California.

"The problem with this argument," the court said, "is . . . [that] the profit figures relied on by [the taxpayer] are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." And the difficulty with the taxpayer's evidence of differing costs, the court said, "is that it does not by itself come close to impeaching the basic rationale behind the three-factor

[7]To forestall any conceptual misunderstanding, we note that one of the two elements of the dormant foreign commerce clause analysis developed by the high court in *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434 and subsequent cases (see *post*, p. __ et seq. [typed maj. opn. p. 19 et seq.]) is the risk of multiple taxation posed by the challenged state taxation method. Although the high court's assessment of the principal division of income methods speaks to that risk, the foregoing summary is undertaken for the limited purpose of gauging the comparative technical or "accounting" merits of the two models, not as part of a dormant commerce clause analysis. (See *post*, p. __ et seq. [typed maj. opn. p. 33 et seq.].)

formula. . . . [¶] Both geographical accounting and formula apportionment are imperfect proxies for an ideal which is not only difficult to achieve in practice, but also difficult to describe in theory. . . . " (*Container, supra*, 463 U.S. at p. 182.) "Of course, even the three-factor formula is necessarily imperfect," the court continued, "[b]ut we have seen no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the sort of separate accounting urged upon us by [taxpayer]." (*Id.*, at pp. 183-184.)

In light of this analysis and the precedents summarized above, we conclude that, in considering the Bank's case for relief, neither of the two methods can lay claim to a decisive technical superiority or greater constitutional stature than the other.[8] We turn, then, to the merits of the Bank's contention that a dormant foreign commerce clause analysis renders unconstitutional the Board's application of the three-factor apportionment formula to the Bank's unitary enterprise.

[8]The Bank argues that the conclusion in the *Container* opinion (*supra*, 463 U.S. at p. 184) that three-factor formula apportionment is a "proper and fair method of taxation" does not mean that its application to foreign-based multinationals produces an accurate determination of their intrastate income. The *Container* characterizations, the Bank contends, are merely the outcome of the four-part dormant interstate commerce clause analysis developed in *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274. This argument strikes us as semantical at best.

The court made clear in *Trinova Corp. v. Michigan Dept. of Treasury*, *supra*, ____ U.S. ____ [111 S.Ct. 881, 835], that if a state tax complies with the requirement of fair apportionment, constitutional demands are exhausted. Moreover, even under a dormant foreign commerce clause analysis, both the trial court and the Court of Appeal concluded — largely under the compulsion of the identical holding in *Container, supra*, 463 U.S. 159 — that the Board's use of worldwide formula apportionment in this case did not offend the risk-of-multiple-taxation leg of the dormant analysis.

III

The Dormant Foreign Commerce Clause Doctrine

Despite the framers' explicit commitment to Congress of the power to "regulate commerce with foreign nations, and among the several states" (U.S. Const., art. I, § 8, cl. 3), by far the bulk of commerce clause jurisprudence has been developed by the high court itself under the judicially created doctrine of the "unexercised," "negative," or "dormant" commerce clause. From its origin early in the nation's constitutional history with the opinion of Chief Justice Marshall in *Gibbons v. Ogden* (1824) 22 U.S. (9 Wheat.) 1, 209, through its reformulation at the hands of Justice Curtis in *Cooley v. Board of Wardens of Port of Philadelphia et al.* (1852) 53 U.S. (12 How.) 298, the high court has posited irreducible and self-executing constitutional minima that limit state action affecting interstate and foreign commerce, even where Congress has *failed* to exert its plenary commerce clause power. "[T]he Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. In short, the Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States. . . ." (*Freeman v. Hewit* (1946) 329 U.S. 249, 252; see also *Southern Pacific Co. v. Arizona* (1945) 325 U.S. 761, 769 ["For a hundred years it has been accepted constitutional doctrine that the commerce clause, without the aid of Congressional legislation . . . affords some protection from state legislation inimical to the national commerce, and that in such cases, where Congress has not acted, this Court, and not the state legislature, is under the commerce clause the final arbiter of the competing demands of state and national interests. [Citations.]"]; *Hood & Sons v. Du Mond* (1949) 336 U.S. 525, 534; *Northwestern Cement Co. v. Minn.* (1959) 358 U.S. 450, 458; *Hughes v. Oklahoma* (1979) 441 U.S. 322, 326, fns. 2 & 3; *Wyoming v. Oklahoma* (Jan. 22, 1992) ___ S.Ct. ___, ___ [60 U.S.L. Week 4119, 4124].)

In the modern era, the consolidative work of the court led it to recast the interstate dimension of the dormant commerce clause doctrine as it applies to state taxation. In *Complete Auto Transit,*

Inc. v. Brady, supra, 430 U.S. 274, the court adopted a four-part test to evaluate state tax schemes to ensure compliance with the inherent demands of the "unexercised" commerce clause. If a tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State," it does not burden impermissibly interstate commerce. (*Id.*, at p. 279.)

This four-part test is not adequate, however, to subserve the additional policies underlying the foreign commerce clause. In *Japan Line, Ltd. v. County of Los Angeles, supra*, 441 U.S. 434 (*Japan Line*), the court held that "[w]hen construing Congress' power to 'regulate Commerce with foreign Nations,' a more extensive constitutional inquiry is required." (*Id.*, at p. 446.) Specifically, "two additional considerations, beyond those articulated in *Complete Auto*, come into play." (*Ibid.*) "In addition to answering the nexus, apportionment, and nondiscrimination questions posed in *Complete Auto*, a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international *multiple taxation*, and second, whether the tax prevents the Federal Government from 'speaking with *one voice* when regulating commercial relations with foreign governments.' If a state tax contravenes either of these precepts, it is unconstitutional under the [foreign] Commerce Clause." (*Id.*, at p. 451, emphasis added.)

Although the court's opinion in *Japan Line, supra*, 441 U.S. 434, stressed the paramount national need for and plenary nature of congressional power over foreign commerce — greater, perhaps, than Congress's textually parallel power over interstate commerce (*id.*, at p. 448 & fns. 12-13) — as one of the fundamental policies animating the framers, it had little to say concerning the preemptive role of Congress in defining the contours of permissible state taxation of foreign commerce. The court illuminated that question a year later when it decided *Mobil Oil, supra*, 445 U.S. 425, a challenge by Mobil to Vermont's tax on foreign dividend income. Rejecting what it termed Mobil's "forced" analogy to California's tax on Japanese shipping containers at issue in *Japan Line*, the court said that the real issue before it was

not one of multiple taxation at the international level, as in *Japan Line*, but of multiple taxation at the state level.

"Concurrent federal and state taxation of income, of course, is a well-established norm," the court wrote. "Absent some *explicit directive from Congress*, we cannot infer that treatment of foreign income at the federal level mandates identical treatment by the States. The absence of any *explicit directive* to that effect is attested by the fact that Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income. [Citations.]" (*Mobil Oil, supra*, 445 U.S. at p. 448, emphasis added.)

The view taken in *Mobil Oil, supra*, 445 U.S. 425, that Congress, under its " 'exclusive and absolute' power . . . over foreign commerce" (*Japan Line, supra*, 441 U.S. at p. 448, fn. 13, quoting *Buttfield v. Stranahan* (1904) 192 U.S. 470, 492), is the source of "explicit directive[s]" *preempting* state taxation of foreign commerce, was amplified in the court's treatment of the issue in *Container, supra*, 463 U.S. 159. The court first noted that "allocating income among various jurisdictions bears some resemblance . . . to slicing a shadow," and concluded that "it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation [i.e., formula apportionment] in favor of another allocation method [i.e., AL/SA] that also sometimes results in double taxation." (*Id.*, at pp. 192-193.) It then turned to the "second inquiry suggested by *Japan Line*," namely, whether California's use of formula apportionment in an international context might " 'impair federal uniformity in an area where federal uniformity is essential,' " and " 'prevent the Federal Government from "speaking with one voice" in international trade.' " (*Ibid.*)

In examining the "one voice" branch of the dormant commerce clause doctrine, the court in *Container* was careful to distinguish between state tax schemes that are unconstitutional because they implicate foreign affairs and those that, although they may have "foreign resonances," are void because they "violate[] a clear federal directive." While either infirmity will offend the "one voice" standard, the latter does so, the court said, not as a result

of a dormant commerce clause analysis, but because of "some *explicit directive from Congress*." This latter analysis, the court noted, "is, of course, essentially a species of pre-emption . . . ." (*Container, supra*, 463 U.S. at p. 194, emphasis added.)

Applying the "explicit directive from Congress" language of *Mobil Oil, supra*, 445 U.S. 425, and canvassing "specific indications of congressional intent," the *Container* opinion found neither statutory preemption by Congress nor any requirement that the AL/SA method be applied to the states in any of the many bilateral tax treaties to which the United States was a signatory. Indeed, the court pointed out, "the Senate has on at least one occasion, in considering a proposed treaty, attached a reservation declining to give its consent to a provision in the treaty that would have extended [an AL/SA] restriction to the States." (*Container, supra*, 463 U.S. at pp. 196-197.) "[I]t remains true," the court concluded, "as we said in *Mobil*, that 'Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income.' " (*Ibid.*)

Although the court concluded in *Container* that the Board's use of formula apportionment did not violate the foreign commerce clause under a dormant analysis, it is important for our purposes to observe that the opinion carefully separates the analytical thread of congressional *preemption* from what the court termed a "more relaxed standard which takes into account our residual concern about the foreign policy implications of California's tax." (*Container, supra*, 463 U.S. at p. 197.) In the former case, there obviously is no need for resort to a dormant analysis since Congress has *explicitly* exerted its plenary authority under the commerce power to *preempt* a state tax scheme that, far from "implicating foreign affairs," has only "foreign resonances."[9] As

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[9]Compare the court's statement in *Merrion v. Jicarilla Apache Tribe* (1982) 455 U.S. 130, 154-155, that "we only engage in [dormant analysis] review when Congress has not acted or purported to act. [Citation.] Once Congress acts, courts are not free to review state taxes or other regulations under the dormant Commerce Clause. When Congress has struck the balance it deems appropriate, the courts are no longer needed to prevent States from burdening commerce, and it

the *Container* opinion makes clear, however, the court will not lightly overturn the historic prerogatives of the states to administer their own tax systems. Before being declared nullified by Congress under this "species of pre-emption," the "federal directive" that a state tax scheme allegedly violates must be "clear." (463 U.S. at p. 194.)

The "more relaxed standard" of a dormant analysis — based on "residual concern[s]" about the "foreign policy implications" of a given state tax scheme — is appropriate only "in the absence of explicit action by Congress" preempting a given state taxation method. It is undertaken by a judiciary with "little competence in determining precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please." (*Container, supra*, 463 U.S. at p. 194.) Thus, it is for reasons of its limited foreign policy expertise that, in conducting a dormant "one voice" inquiry, the "best that [a court] can do, in the absence of explicit action by Congress [preempting a challenged state tax scheme], is to attempt to develop objective standards that reflect very general observations about the imperatives of international trade and international relations." (*Ibid.*) Where they apply, the development of such standards is informed significantly by the views of executive officials charged with implementing the nation's foreign policy — including its foreign commercial policy — "whose nuances ... are much more the province of the Executive Branch and Congress than of this Court." (*Id.*, at p. 196.)

As might be expected, the Bank argues at length that the Board's application of formula apportionment to the unitary business of which it is a part offends the foreign commerce clause precisely because it violates a "clear federal directive." That directive, the Bank tells us, is embodied in an impressive array of federal executive communications — presidential statements and

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matters not that the courts would invalidate the state tax or regulation under the Commerce Clause in the absence of congressional action. [Citation.] Courts are final arbiters under the Commerce Clause only when Congress has not acted."

press releases; official letters from cabinet officers charged with overseeing national monetary, trade, and foreign policies; the testimony of senior Treasury Department officials; and the "white paper" of an executive task force established to study and present recommendations on the issues surrounding state use of formula apportionment to foreign-based unitary groups. Without exception, the Bank argues, these executive sources vigorously and explicitly support the exclusive use of the AL/SA method in such circumstances and condemn the use of formula apportionment by the states.

The Court of Appeal essentially agreed with the Bank's underlying premise that *executive* pronouncements of what national foreign commercial policy *should* be qualifies as a source of the "clear federal directive." It reasoned that because the *Container* opinion (*supra*, 463 U.S. 159) subsumed the search for specific indications of congressional intent within the "one voice" standard, congressional intent must therefore be an integral component of the dormant commerce clause test. From that analytical keystone, it had little difficultly in concluding on the basis of a substantial executive-compiled record that the federal directive was clear and explicit: according to executive branch officials, formula apportionment, in the words of the Court of Appeal, "is not to be applied to foreign-based corporate groups — those groups are to be taxed by the states only on income derived from the United States."

Were we confronted with the Bank's argument in the immediate aftermath of the *Container* decision, it might carry some force, although given the absence of textual support for the claim — both in the *Container* opinion and the commerce clause itself — it is by no means facially convincing. The fact is, however, that dormant foreign commerce clause jurisprudence has evolved in the nine years since *Container, supra*, 463 U.S. 159, was decided, an evolution that, as we parse the cases, has reoriented the doctrine. That development has reduced the scope for a dormant analysis and makes its invocation here particularly inappropriate.

IV

Wardair: A "Governmental Silence" of a Different Kind.

Three years after its opinion in *Container, supra,* 463 U.S. 159, upholding California's use of formula apportionment in calculating the intrastate tax liability of a domestic-based unitary business, the high court decided ***Wardair Canada v. Florida Dept. of Revenue*** (1986) 477 U.S. 1 (***Wardair***). At issue was a Canadian-based international air carrier's challenge to an excise tax assessed by Florida on intrastate fuel purchases by common carriers, including airlines. The tax was levied at the rate of 5 percent on a deemed fuel price of $1.148 per gallon; air carriers were liable for the full amount of the tax whether the fuel was consumed in flights within or outside the state, regardless of the amount of intrastate business transacted by the taxpayer. (*Id.,* at p. 4.)

In attacking application of the tax to its Florida fuel purchases on foreign commerce clause grounds, the carrier — joined by the United States as amicus curiae — conceded that the tax, being assessed on discrete intrastate transactions, presented no risk of multiple international taxation. It relied instead entirely on the "one voice" element of the dormant foreign commerce clause analysis, the last of the six factors identified by the court in *Japan Line, supra,* 441 U.S. 434.

Specifically, the carrier contended that a patchwork of reciprocal tax exemptions, embodied in a network of multilateral agreements and conventions to which the United States was a party, manifested a national policy to exempt from state taxation the instrumentalities of international air commerce, including aviation gasoline. Florida's excise on aviation fuel purchased by a foreign carrier engaged in international air commerce, the carrier claimed, was inconsistent with that univocal national policy, thus threatening "the ability of the Federal Government to 'speak with one voice.'" (***Wardair, supra,*** 477 U.S. at p. 9.)

The high court rejected the claim. Not only did the matrix of international conventions, resolutions and air commerce agreements relied on by the carrier and the United States fail to sustain a federal policy pretermiting Florida's excise on aviation fuel, the high court said, "but, even more fundamentally, [it] shows also that in the context of this case we do not confront federal governmental silence of the sort that triggers dormant Commerce Clause analysis." In point of fact, the court continued, "the international agreements cited demonstrate that the Federal Government has affirmatively acted, rather than remained silent, with respect to the power of the States to tax aviation fuel, and thus that the case does not call for dormant Commerce Clause analysis at all." (***Wardair, supra,*** 477 U.S. at p. 9.)

As we explain below, the court's opinion in ***Wardair, supra,*** 477 U.S. 1, establishes an interpretive framework for educing from a compilation of legislative materials a species of governmental *silence* that forecloses resort to a dormant foreign commerce clause analysis. In some cases where Congress affirmatively declines to adopt certain measures, the resulting governmental "silence" is not the sort that triggers use of a dormant foreign commerce clause analysis. Properly applied under the appropriate conditions, the ***Wardair*** methodology interdicts judicial resort to executive branch opinions as to the international commercial effect of a challenged state taxation practice because Congress has "acquiesced in" the contested practice, thereby validating it. (*Id.,* at p. 12.) Where appropriate, ***Wardair*** supplants what the court has termed the "quagmire" of dormant commerce clause analysis (*Northwestern Cement Co. v. Minn., supra,* 358 U.S. 450, 458) with a heightened judicial attentiveness to expressions of congressional foreign commerce policy. Because it delimits use of dormant foreign commerce clause analysis in important ways, it is useful to lay out the analytical lines of the ***Wardair*** paradigm in some detail before applying it to the case before us.

The foreign carrier in ***Wardair, supra,*** 477 U.S. 1, relied on a hierarchy of multinational agreements to support its thesis that federal policy precluded state taxation of intrastate aviation fuel purchases by international carriers: the Chicago Convention on International Civil Aviation (Convention), signed in 1944 by the United States, Canada, and 155 other nations; a resolution adopted in 1966 by the International Civil Aviation Organization, of which the United States was a member by virtue of being a signatory to the Convention; and more than 70 bilateral international aviation agreements between the United States and foreign

nations, including a United States-Canadian aviation agreement. (*Wardair, supra*, at p. 10.) But it was these very texts, the high court concluded, that in combination impeached the existence of a national policy to exempt international air commerce from state taxation and, by their "negative implications," supported an inference that "the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel." (*Id.*, at p. 12.)

First, a provision of the Convention explicitly prohibited taxation by both national and subnational governmental units of fuel "on board" arriving international aircraft. The Convention failed, however, to reach the issue of taxing intrastate fuel *purchases* by foreign aircraft following their arrival. This omission, the court reasoned, demonstrated by "negative implication" the "international community's awareness of the problem of state and local taxation of international air travel . . . and represent[ed] a decision by the parties to [the] Convention to address the problem by curtailing . . . only some of the localities' power to tax, while implicitly preserving other aspects of that authority." (*Wardair, supra*, 477 U.S. at p. 10.)

Second, the resolution relied on by the carrier, although endorsing an international regime prohibiting duties of any kind by any taxing authority on international air travel, had "not been specifically endorsed, let alone signed, entered into, agreed upon, approved, or passed by either the Executive or Legislative Branch of the Federal Government. In other words, no action has been taken to give the Resolution the force of law." (*Wardair, supra*, 477 U.S. at p. 11.) It thus could not tenably represent, the court concluded, "a policy *of the United States*, as opposed to a policy of an organization of which the United States is one of many members." (*Ibid.*, emphasis in original.)

Third, in the years following the Convention, the United States entered into more than 70 bilateral international civil aviation agreements, "in not one of [which] has the United States agreed to deny the States the power asserted by Florida in this case." Significantly, most of these agreements "explicitly commit the United States to refrain from imposing *national* taxes on aviation fuel used by airlines of the other contracting party . . . but . . .

none . . . explicitly interdicts state or local taxes on aviation fuel used by foreign airlines in international traffic." (*Wardair, supra*, 477 U.S. at p. 11, emphasis in original internal quotation marks omitted.) Reenforcing this view, the United States-Canadian agreement also limited tax exemptions granted foreign air carriers to "national duties and charges," an "omission [to reach subnational duties] which must be understood as representing a policy choice by the contracting parties. . . . " (*Ibid.*)

Summing up the implications of this mosaic of texts for a dormant commerce clause attack on Florida's tax, the court concluded that "[w]hat all of this makes abundantly clear is that the Federal Government has not remained silent with regard to the question whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel." (*Wardair, supra*, 477 U.S. at p. 12.) "It would turn dormant commerce Clause analysis entirely upside down," the court continued, "to apply it where the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow. For the dormant Commerce Clause, in both its interstate and foreign incarnations, only operates where the Federal Government has *not spoken. . . .* " (*Ibid.*, first emphasis in original, second emphasis added.)

For our purposes, the high court's analysis of the textual materials in *Wardair, supra*, 477 U.S. 1, can be abstracted into a kind of protocol for identifying those kinds of governmental silences that give rise to "negative implications" supporting an inference of federal acquiescence in the state tax under challenge. Thus, in *Wardair* the court found that bilateral recognition of an international taxation issue and its specific treatment at the national level (numerous international aviation agreements exempting foreign air carriers from national duties), impliedly supported a finding that the failure to address the correlative issue at the subnational level represented "a policy choice by the contracting parties." (*Id.*, at p. 11.)

By a kind of parity of reasoning, *Wardair* found that the explicit treatment of *some* subnational aspects of an international taxation issue (Convention prohibition on state taxation of fuel aboard

arriving foreign aircraft) supported an inference of international "awareness of the problem" at the state level and a "decision . . . to address the problem by [limited curtailment of the subnational power] . . . while implicitly preserving other aspects of [subnational] authority." (477 U.S. at p. 10.) Last, the court found that notwithstanding an international aspiration to erect a particular tax regime (the resolution's endorsement of the complete eradication of national and subnational duties on international air travel), the fact that domestic "*law* as it presently stands acquiesces in taxation . . . by political subdivisions" was decisive of the commerce clause issue. (*Ibid.*, emphasis in original.)

Before considering the history of congressional consideration of curbs on the states' application of formula apportionment to foreign-based multinationals in light of the court's analysis in *Wardair*, we first consider the treatment of *Wardair* at the hands of the Court of Appeal.

V

The Wardair Canon and Congressional Refusal to Prohibit State Use of Formula Apportionment

A

As noted *ante*, the Court of Appeal declined to accept the view that *Wardair, supra*, 477 U.S. 1, represents, if not a change of course in the high court's dormant foreign commerce clause jurisprudence, at least a retrenchment in its scope. It also concluded that statements of executive branch officials as to United States foreign commercial policy could constitute the "clear federal directive" component to the "one voice" analysis of *Japan Line, supra*, 441 U.S. 434, *Mobil Oil, supra*, 445 U.S. 425, and *Container, supra*, 463 U.S. 159.

In our view, both of these conclusions are born of the root error of failing to grasp the conceptual impact of *Wardair, supra*, 477 U.S. 1, on dormant foreign commerce clause doctrine. As we explain, the failure of the Court of Appeal to appreciate *Wardair's* limitations on dormant commerce clause analysis is cognate to its erroneous view that executive branch aspirations as

to what national foreign commercial policy ought to be can constitute a "clear federal directive," at least where, under a *Wardair* analysis, Congress has decreed otherwise.

The Court of Appeal rejected the Board's argument that *Japan Line, Container,* and *Wardair* demonstrate a trend in foreign commerce clause jurisprudence toward a heightened attention to governmental expressions of United States foreign commercial policy. Instead, it concluded that "the theoretical underpinning has remained intact through these cases." What was different in them, it thought, "was the degree to which foreign affairs and international commercial relations where implicated" by the challenged state tax scheme.

It may be that the application of such a theme to these three cases would produce a coherent alternative explanation of the results reached by the high court. To contend, however, that *Wardair, supra*, 477 U.S. 1, turns on "the degree of which foreign affairs and international commercial relations were implicated," is to misread fundamentally the court's opinion. Such a view ignores the high court's explicit statement that in *Wardair* it "[did] not confront federal governmental silence of the sort that triggers dormant Commerce Clause analysis," that the case "does not call for dormant Commerce Clause analysis at all," and that "[i]t would turn dormant Commerce Clause analysis entirely upside down to apply it where the Federal Government has acted." (*Id.*, at pp. 9, 12.) We are confident that the overarching significance of *Wardair* lies in its explicit limitation on when a dormant foreign commerce clause analysis is appropriate, its affirmation that the analysis "only operates where the Federal Government has not spoken," and its statement that the court "[has] never suggested . . . that the Foreign Commerce Clause *insists* that the Federal Government speak with any particular voice." (*Id.*, at pp. 12, 13, emphasis in original.)

The Court of Appeal's misapprehension of this central meaning of *Wardair*, supra, 477 U.S. 1, led it to a related error — the conclusion, against the backdrop of an explicit *congressional* refusal to adopt curbs on state use of formula apportionment, that a trial of letters, press releases, task force reports, transcripts of congressional testimony of Treasury Department officials, and like

communications orchestrated by the executive branch could constitute a "clear federal directive" condemning state use of formula apportionment in foreign parent cases. As we have indicated, however, the "clear federal directive" formulation in *Container, supra*, 463 U.S. 159, has no role to play in a dormant foreign commerce clause analysis; rather, it confirms the preemptive power of *Congress* to interdict state tax schemes that would, had Congress *not* chosen to act, survive challenge under a dormant foreign commerce clause analysis because they present only "foreign resonances." (*Id.*, at p. 194.)

Whether, in the absence of a congressionally enacted "clear federal directive," the executive branch can itself assume a preemptive role and in effect nullify state tax schemes as they affect foreign-based businesses is a distinctly different question. The Court of Appeal, relying principally on the concurring opinion of Justice Jackson in *Youngstown Co. v. Sawyer* (1952) 343 U.S. 579, 634 — the famous "steel seizure case" — concluded that such a power inhered in the President's authority to conduct foreign affairs and that the executive had spoken with sufficient clarity to prohibit state application of formula apportionment to foreign parent unitary groups such as the Bank.

In light of *Wardair, supra*, 447 U.S. 1, we need not and do not reach this issue. For in the debate over state use of worldwide formula apportionment — a controversy waged on multiple fronts by foreign governments, multinationals and their domestic and foreign affiliates, state tax authorities, senior Treasury and State Department officials, the White House and Congress — we hear the din of a "governmental silence" that cannot be ignored. In our view, Congress, after being repeatedly pushed and pulled in both directions, at least for the present has decided *not* to prohibit state use of formula apportionment in cases of this kind. To paraphrase the *Wardair* opinion, international agreements demonstrate that the federal governmental has affirmatively acted, rather than remained silent, with respect to the power of the states to employ formula apportionment in so-called foreign parent cases; as a result, this case does not call for dormant foreign commerce clause analysis at all. (477 U.S. at p. 9.)

As we explain in some detail below, over the past 25 years, senior tax and foreign policy officials of the executive branch have sought to respond to the demands of foreign governments that the states be barred from applying formula apportionment to determine the tax liability of foreign-based multinationals. For much of this period, the chief forum for resulting executive branch initiatives was the Senate, where successive administrations sought to win ratification of a treaty provision barring state use of formula apportionment. But in 1978, with explicit recognition of the "negative implications" of its act, the Senate *rejected* an income tax convention negotiated by the executive branch with the United Kingdom whose centerpiece was a provision — article 9(4) — prohibiting the states from using formula apportionment in determining the intrastate tax liability of United Kingdom-based multinationals. Only after the ban on state use of formula apportionment was stricken was the administration able to muster the two-thirds majority required for Senate ratification under the treaty clause.

In addition, numerous bilateral tax treaties between the United States and other nations, although precluding use of formula apportionment by the signatory *national* governments, do not include within that prohibition political subdivisions such as the states. And while such tax treaties *do* include subnational governments within the scope of nondiscrimination provisions, they are *not* included within the prescription that the signatory governments employ an AL/SA methodology in taxing local branches of foreign corporations. Similarly, so-called "Friendship, Commerce and Navigation" treaties — a common form of commercial agreement between the United States and its trading partners — typically require both the federal and state governments to tax foreign enterprises within their jurisdictions on a "reasonably allocable or apportionable" basis, a standard which United States drafters viewed as "intended to cover all the various methods, proportionate or otherwise, by which a reasonable tax base might be determined." (U.S. State Dept., Standard Draft Treaty of Friendship, Commerce and Navigation, prepared by Charles H. Sullivan (Aug. 1980) pp. 202, 203.)

Finally, in the wake of Senate rejection of article 9(4) and the decision in *Container, supra*, 463 U.S. 159, upholding California's use of worldwide unitary methods in taxing domestic-parent multinationals, the executive branch scuttled its effort to achieve treaty-imposed curbs on the states' use of worldwide formula apportionment. Instead, the administration proceeded on other fronts, first seeking the voluntary cooperation of the states in mitigating the internationally effects of formula apportionment and, in a new tack, presenting its views in selected litigation through amicus curiae participation, before again renewing its call for Congress to enact restrictive legislation.

It is in the course of this undertaking that the executive branch has produced what the Bank insists is the "clear federal directive" that sustains its dormant foreign commerce clause case. We think, however, that rather than qualifying as a "clear federal directive," these materials, in the context of Congress's persistent refusal to regulate state taxation of multinationals and the Senate's explicit rejection of article 9(4) of the United States-United Kingdom treaty, embody nothing more than executive aspirations of what the federal government's policy in this area *ought* to be.

B

In 1975, the Ford administration concluded a bilateral income tax convention with the United Kingdom, a central feature of which was the following provision, article 9(4):

"Except as specifically provided in this Article, in determining the tax liability of an enterprise doing business in a Contracting State, or in a political subdivision or local authority of a Contracting State, such Contracting State, political subdivision or local authority shall not take into account the income, deductions, receipts, or outgoings of a related enterprise of the other Contracting State or of an enterprise of any third State related to an enterprise of the other Contracting State."[10]

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[10](Convention Between United States and United Kingdom for Avoidance of Double Taxation, Dec. 31, 1975, 31 U.S.T. 5670, 5677, T.I.A.S. 9682.)

When the succeeding Carter administration sought Senate ratification of the convention, state tax authorities attacked article 9(4) as an infringement on state powers of taxation, reached by executive branch negotiators without prior consultation with the states. They vigorously lobbied for its excision. Following a series of committee and floor votes, the Senate ultimately ratified the treaty, subject to the telling reservation "that the provisions of paragraph (4) of Article 9 . . . shall not apply to any political subdivision or local authority of the United States." (124 Cong. Rec. 18416 (1978).)

Explaining one of the motivations behind the reservation, which in effect struck article 9(4) from the treaty, its chief proponent objected to executive branch use of "the device of a tax treaty" to "impose major changes in internal tax policy" by circumventing congressional consideration of the states' use of formula apportionment. (Remarks of Sen. Church, 124 Cong. Rec. 18416 (1978).) "For some 10 years," the sponsor of the reservation stated, "Congress has been rejecting the type of limitation on the power of our State governments to tax which is incorporated in article 9(4) of the pending treaty." (*Ibid.*) Immediately following ratification of the United States-United Kingdom tax convention as amended by the so-called "Church reservation," Senator Javits, a chief sponsor of the treaty, including article 9(4), noted that "what we [the Senate] have done is very serious . . . We have for all practical purposes eliminated a very important provision of this treaty [article 9(4)] for which the United Kingdom believed it had entered into the treaty." (Remarks of Sen. Javits, 124 Cong. Rec. 19077 (1978).)

The parallels between this evidence of "governmental silence" or refusal to act and that regarded as decisive in *Wardair, supra*, 477 U.S. 1, seem to us both evident and compelling. As in *Wardair*, an international agreement (here the bilateral income tax treaty between the United States and the United Kingdom) demonstrates that while federal executive branch officials *aspired* to eliminate a state tax practice (here the use of formula apportionment to calculate the tax liability of foreign-based multinationals), "the *law* as it presently stands acquiesces" in the states' continued use of that practice. As in *Wardair*, "the negative

implications" of international agreements (here the tax treaty as ratified by the Senate) support recognition of a federal policy that *acquiesces* in the states' tax practice. And certainly, in the circumstances of Senate consideration detailed above, the explicit removal of "political subdivisions" from the scope of article 9(4) effected by the Church reservation, like the omission of restrictions on taxation by political subdivisions in the international agreements considered in *Wardair*, "must be understood as representing a policy choice by the contracting parties." (*Wardair, supra*, 477 U.S. at p. 11.)[11]

The Court of Appeal rejected the analogy to *Wardair, supra*, 477 U.S. 1, on the ground that, in both a committee vote and on the Senate floor, the Church reservation failed to command a plurality, and the vote for the treaty *with* article 9(4) was only five votes short of the needed two-thirds majority. In light of these tallies, it reasoned that it was difficult to see a congressional policy permitting the states to use formula apportionment. In our view, however, the focus on preliminary votes misses the mark.

Preliminary voting tallies lack meaning precisely because they are not definitive, may be cast for any number of tactical parliamentary reasons, and thus do not reliably reflect legislative policy. The sole constitutional mechanism for congressional consideration of executive-negotiated treaties is Senate ratification by a two-thirds majority (U.S. Const., art. II, § 2); to that defining vote, institutional significance sensibly can and should be ascribed. In any case, the method enjoined upon us by *Wardair, supra*, 477 U.S. 1, requires that we ponder the significance of "the *law* as it stands," not count noses.

The Senate's action with respect to article 9(4) is only the most explicit example of a persistent congressional refusal to enact curbs on the states' use of worldwide formula apportionment reaching back well before 1977, the tax year at issue in this case. The parties agreed in a pretrial stipulation that "various proposed Legislative bills have been introduced in the United States Congress that would, among other things, affect the states' use of worldwide combined reporting." The stipulation identifies twenty such House and Senate bills spanning twenty years. These range from House Resolution No. 11798 introduced in the House in 1965 (an ambitious "Interstate Taxation Act" that would have required the states to adopt a two-factor apportionment formula in taxing unitary groups) to 1985 legislation sponsored by the Treasury Department that would have limited state use of worldwide formula apportionment to members of foreign-based corporate groups actually doing business in the United States, that is, so-called "water's edge" legislation. (See *post*, p. ___ [typed maj. opn. pp. 52-54].) None of these measures was enacted into law by Congress.

We likewise part company with the Court of Appeal in its view of the significance to be drawn from the web of bilateral tax conventions into which the United States has entered both before and after the Senate's rejection of article 9(4). As noted, these conventions typically require use of the separate accounting method by the national signatory governments in their tax treatment of domestic branches of foreign-based businesses.[12] This restriction, however, does not encompass division of income methods used by political subdivisions of the contracting states.

Again, the Court of Appeal found the analogy to *Wardair, supra*, 477 U.S. 1, inapt because, unlike that case — in which subsequent air commerce agreements rested on the foundational understanding of the Convention — many of the agreements relied on by the Board in this case predate an international awareness of formula apportionment issues that did not arise until the 1970's. Thus, according to the Court of Appeal, affirmative

[11] Parliament eventually acceded to Congress's demands, ratifying the income tax convention without article 9(4). (See 31 U.S.T., *supra*, 5709-5710.)

[12] Representative treaty language appears, for example, in article VII, section 2 of the United States-Canadian treaty of 1984, providing for tax treatment of domestic branches of foreign-domiciled corporations as "if it were a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently" with the rest of the corporation. (Convention Between United States and Canada with Respect to Taxes on Income and Capital, Aug. 16, 1984.)

prescriptions of national division of income methods in international treaties would not support *Wardair's* "negative implications" that the parties were aware of competing methods and made the conscious decision to acquiesce in their use by the states.

Despite the facial plausibility of this reasoning, we cannot accept the supposition underlying it that formula apportionment as a division of income alternative to separate accounting for taxation purposes did not penetrate the international financial and diplomatic consciousness until the multinational corporate boom of the 1970's. The high court's 1924 decision in *Bass, supra*, 266 U.S. 271, upholding the constitutionality of state use of formula apportionment to a United Kingdom-based taxpayer, suggests at a minimum notice to the international business community of the valid use of an alternative to separate accounting by political subdivisions of the United States.

Although the Court of Appeal also rejected this argument on the ground that "awareness of a particular tax theory is one thing; to be subjected to that theory in practice is quite another," we think that this reasoning requires greater proof than that demanded by *Wardair, supra*, 477 U.S. 1. The dramatic growth of multinationals during the 1960's and 1970's may well have served to sharpen corporate concern over the international effects of the states' use of formula apportionment, but that increased apprehension does not demonstrate a prior lack of awareness of its potential applicability or negate the sensible decision of United States treaty negotiators — operating with an awareness of a federalist-based tax practice — to include a standard provision limiting only national governments to the AL/SA method.[13]

[13]Thus, one of the leading spokesmen of executive branch opposition to state use of the worldwide unitary method, Donald Lubick, Assistant Secretary of the Treasury for Tax Policy, explained why, except for the nondiscrimination clause, subnational taxes were not included in the United States Model Income Tax Treaty by noting that "local U.S. taxes are not covered because it is unlikely that the United States would consent to the ratification of any treaty provision that restricted the rights of the ... states to impose their own taxes." (See International

There is evidence suggesting a basis for just such an international recognition of formula apportionment as a competing taxation method, at least from the mid-1950's on. The *Container* case itself dealt with California's use of formula apportionment for the 1963 to 1965 tax years (463 U.S. at p. 171) and a prior decision of our Court of Appeal (*Anaconda Co. v. Franchise Tax Board* (1982) 130 Cal.App.3d 15) dealt with the tax years 1955 through 1969.[14] Moreover, in enacting the Internal Revenue Act of 1956, Congress authorized the Secretary of the Treasury to "distribute, *apportion*, or allocate gross income ... between or among" multicorporate enterprises, including those with foreign domiciles, "in order ... clearly to reflect [their] income" (26 U.S.C. § 482, emphasis added), a formulation that reflects at least an awareness of apportionment methodologies.[15] Similarly, as early as the late 1940's, United States negotiators of "Freedom, Commerce and Navigation" agreements incorporated standards to preserve the states' freedom to employ methods that produced a tax "reasonably allocable or apportionable" to the taxing jurisdiction, a formulation American drafters described as limiting state levies to "a fair portion of a global income derived from dual or multiple territorial sources." (U.S. State Dept., Anno. Draft

Tax Treaties: Hearing Before the Sen. Com. on Foreign Relations, 96th Cong., 1st. Sess., at p. 112.)

The United States (together with two other federalist nations, Canada and Australia) likewise reserved its position "on that part of paragraph 1 [of article 1 of the Organization for Economic Co-operation and Development [OECD] Model Taxation Convention] which states that the Convention [which requires use of a separate accounting method] should apply to taxes of political subdivisions or local authorities." (Model Double Taxation Convention on Income and on Capital (1977), at p. 50.)

[14]A key 1984 Treasury Department document notes that debate on state use of the worldwide version of formula apportionment "spans *at least two decades.*" (Chairman's Rep., *supra*, at p. 3, emphasis added.)

[15]The 1954 version, as well as the current version of 26 United States Code section 482, derives from section 45 of the Revenue Act of 1928. (See H.R. Rep. No. 2, 70th Cong., 1st Sess., p. 16 (1928).)

Treaty of Friendship, Commerce and Navigation for Portugal, prepared by Herman Walker (1947-1948) pp. 14a, 15.)

In addition, bilateral income tax treaties negotiated by the United States with many of its trading partners typically prescribe use of the AL/SA method by the signatory governments; they do not, however, impose such a requirement on taxation by subnational levels of government. Moreover, despite this methodological exemption, subnational organs of government *are* included for purposes of nondiscrimination treaty provisions. We think this latter evidence substantially parallels the *Wardair* paradigm, where the high court concluded that the "negative implications" arising from the Convention's limited ban on state taxation of fuel "on board" arriving foreign aircraft demonstrated an awareness of subnational taxation issues and represented "a decision by the parties . . . to address the problem by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority." (*Wardair, supra*, 477 U.S. at p. 10.) In short, an extensive pattern of executive branch-negotiated diplomatic texts parallels, in our view, Congress's own unwillingness to disallow legislatively the states' application of formula apportionment methods to foreign-controlled multinational taxpayers, and bespeaks a coordinate "acquiescence."

Finally, the strategy pursued by the executive branch in the wake of the high court's opinion in *Container, supra*, 463 U.S. 159, underlines the aspirational character of its insistence on an end to state use of formula apportionment in foreign-parent cases. Although in the immediate aftermath of the decision, the administration rejected appeals by the business community and major trading partners to seek amicus curiae status in *Container* and support a rehearing, the White House soon announced an alternative plan.[16]

President Reagan directed the Secretary of the Treasury to establish a "working group" composed of representatives of the federal and state governments and the business community

[16]Pleas for administration support for a rehearing and for congressional legislation and the administrations' reaction are detailed in the Chairman's Report, *supra*, at pages 2-3.

"charged with producing recommendations . . . that will be conducive to harmonious international economic relations, while also respecting the fiscal rights and privileges of the individual states." (Chairman's Rep., *supra*, at p. ii; see also 48 Fed.Reg. 208, p. 49570 (Oct. 26, 1983).) The final report of the working group, released in 1984 as the Chairman's Report, *ante*, footnote 3, recommended efforts by the states to mitigate the international effects of formula apportionment, including limiting its use to the "water's edge," (that is, excluding from the unitary tax base members of foreign-controlled groups not doing business in the United States). Although these state efforts at reform were to be "voluntary," in his transmittal letter to the President, Treasury Secretary Regan stated that "If there are not sufficient signs of appreciable progress by the states in this area by . . . next year, . . . I will recommend to you that the Administration propose federal legislation that would give effect to a water's edge limitation patterned after that in [the report]." (Chairman's Rep., *supra*, at p. iii.)

Eighteen months later, the administration followed up on its threat to seek congressional action. In a November 1985 statement, the President called for federal legislation that would require the states to adopt "water's edge" restrictions on the use of worldwide formula apportionment and directed the Treasury Secretary to "work with the Congress for [its] passage." At the same time, the President directed the Attorney General "to ensure that the United States' interests are represented in appropriate controversies and cases consistent with [the] approach" outlined in the President's statement. (45 Weekly Compilation of Pres. Documents 1368.) In January 1986, Secretary of State Shultz wrote to then-Governor Deukmejian informing him that legislation had been introduced before Congress "at the express direction of the President" that "would prohibit states from taxing corporations under the worldwide unitary method." (Letter of Jan. 30, 1986, from Sect. of State Shultz to Governor Deukmejian.)[17]

[17]Neither the Senate nor the companion House versions of the Treasury Department-drafted legislation were enacted. (See Remarks of

As a result of executive branch initiatives, some states agreed to cease using the formula apportionment method in the case of foreign-parent multinationals.[18] Others, California among them, adopted meliorative measures designed to pacify critics. In 1986, our Legislature enacted "water's edge" legislation,[19] prompting senior Treasury Department officials to retreat from their previous insistence that Congress prohibit state use of worldwide formula apportionment. For the time being, the administration told Congress, neither prohibitory congressional legislation nor treaty restrictions on state use of worldwide unitary methods was appropriate.[20]

As this account rather pointedly makes clear, the struggle for supremacy between the major interests with a stake in the fate of worldwide formula apportionment — states using that method and their federalist allies, on the one hand, and aggrieved multinationals and their supporters in the business community and

Sen. Wilson on Sen. No. 1974, 131 Cong. Rec. S17975, daily ed. Dec. 18, 1985; remarks of Representative Duncan on H.R. No. 3980, 131 Cong. Rec. E574, daily ed. Dec. 19, 1985.)

On the legal front, the Solicitor General filed a brief amicus curiae in *Wardair, supra*, 477 U.S. 1, supporting the foreign air carrier in its unsuccessful contention that Florida's tax on aviation fuel was unconstitutional under a dormant foreign commerce clause analysis. (*Id.*, at p. 9.)

[18](See, e.g., Langbein, *The Unitary Method and the Myth of Arm's Length, supra*, 30 Tax Notes at p. 674, fn. 1. [by early 1986, four of the twelve states using worldwide unitary methods, "including all of the commercially significant states except California," had repealed them].)

[19](See Rev. & Tax. Code, § 25110 et seq.)

[20](Statement of J. Roger Mentz, Asst. Sect. of the Treas. for Tax Policy, before the Subcom. on Taxation and Debt Management, Sen. Finance Com. (Sept. 29, 1986), at pp. 2-3.) The Assistant Secretary's comments, stating the administration's position on Senate Bill No. 1974 — the Treasury Department-sponsored legislation drawn up at President Reagan's direction — included the view that "Congressional action on S. 1974 should be deferred until the remaining worldwide unitary states have a full opportunity to act . . ." and that "a treaty resolution of the unitary issue is [not] necessary or appropriate at this time." *(Ibid.)*

the executive branch, on the other — has a long history. For much of this history, executive officials have sought unsuccessfully to impose their solution on the states through Senate ratification of a treaty provision embodying curbs and, failing that, legislation enacted under Congress's foreign commerce clause power.

Only late in the campaign have the partisans of separate accounting changed the locus of attack by seeking to have the worldwide use of formula apportionment by the states judicially invalidated on dormant foreign commerce clause grounds. In pressing that challenge, opponents of the worldwide unitary method have marshalled executive branch arguments designed to persuade Congress and the states to legislate curbs, and have attempted to transmute them into the "clear federal directive" of *Container, supra*, 463 U.S. 159.[21] As explained above, however, that doctrine underlines the plenary power of *Congress* to preempt state taxation methods with "foreign resonances"; it does not give executive officials carte blanche to declare state tax methods null when they irritate our trading partners.[22]

[21]These materials consist largely of numerous diplomatic notes of complaint ("demarches") filed with the United States by its trading partners objecting to the states' use of worldwide formula apportionment, presidential statements, statements and letters from cabinet officers and other senior Treasury and State Department officials to the same effect, and official documents such as the Chairman's Report, *supra*. As noted, there is no doubt that many foreign governments object strenuously to the practice and that executive branch officials charged with conducting American foreign commercial policy agree with them.

[22]We thus reject the claim of the United States Department of Justice, appearing as amicus curiae in support of the Bank, that California's use of formula apportionment in this case is "an egregious interference with the Federal Executive's conduct of foreign affairs and is thus patently unconstitutional." Although we accept the Justice Department's argument that the views of the executive branch on the international effect of state taxation practices are entitled to "great weight" under a foreign dormant commerce clause analysis (cf. *Container, supra*, 463 U.S. at p. 196), our conclusion that such an analysis is not triggered here forecloses resort to those views. (Compare

Conclusion

It is clear that federal limitations on the states' use of worldwide formula apportionment is a controversial political and economic issue of which Congress has long been aware. In light of that history, we cannot turn away from the substantial evidence of Congress's repeated refusal to intervene in the regulation of state division of income methods for tax purposes, even one that provokes continuing international complaint. Under the compulsions of established constitutional doctrine, the courts sometimes are required to divine what foreign commerce policy Congress would pursue in the absence of any indication that it has thought about the subject; it is a quite different matter, however, for a court to ignore a pattern of congressional action that evidences both an awareness of an issue and a refusal to adopt the remedy urged upon it by executive officials and resisted by its state constituencies. The latter, we believe, viewed in context alongside additional treaty materials, is a governmental silence that is eloquent.

In light of Congress's awareness of antagonistic state taxation and international business interests, the path taken by the high court in *Wardair, supra*, 477 U.S. 1, seems the constitutionally correct one here. To invest a paper trail of executive aspiration with the dignity of a "clear federal directive" would, in the language of *Wardair*, "turn dormant Commerce Clause analysis entirely upside down." (*Id.*, at p. 12.) Taking our lead from the high court, we decline to adjudicate on dormant foreign commerce clause grounds a debate between the political branches of the federal government over what is, in both its international and federalist dimensions, a sharply contested issue of national tax policy that has been repeatedly aired before Congress. We adhere to the central meaning of the high court's opinion in *Wardair* in holding that Congress's refusal to legislate restrictions on state use of worldwide formula apportionment is not the sort of governmental silence that triggers a dormant foreign commerce clause analysis.

Wardair, surpa, 477 U.S. at p. 9 [rejecting views of United States as amicus curiae].)

Our holding does not end the matter, however. The trial court held that the cost to a foreign-based unitary enterprise of furnishing financial data required by the Board's use of the worldwide formula apportionment method — the so-called "compliance burden" — violated due process. In addition, it held that same burden violated the nondiscrimination requirement of the four-part dormant interstate commerce clause analysis under *Complete Auto Transit, Inc. v. Brady, supra*, 430 U.S. 274.

The Court of Appeal explicitly declined to decide the due process issue and does not appear to have passed directly on the nondiscrimination issue. The due process issue is a fact-dependent question that should be decided by the Court of Appeal in the first instance; moreover, we think its examination of the issue would profit from a consideration of its merit free of the view that a dormant foreign commerce clause analysis is appropriate in the circumstances present here.

Accordingly, the judgment of the Court of Appeal is reversed and the cause is remanded to that court for further proceedings consistent with this opinion.

ARABIAN, J.

WE CONCUR:

LUCAS, C. J.
MOSK, J.
PANELLI, J.
KENNARD, J.
BAXTER, J.
GEORGE, J.

BARCLAYS BANK INTERNATIONAL, LTD. v.
FRANCHISE TAX BOARD

S019064

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TRIAL COURT:	Sacramento County Superior Court
TRIAL COURT #:	325059

The information provided here is not intended to reflect that which will appear in official reports.

APPENDIX D

CERTIFIED FOR PUBLICATION

COURT OF APPEAL OF THE STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT

(Sacramento)

BARCLAYS BANK INTERNATIONAL LIMITED,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

BARCLAYS BANK OF CALIFORNIA,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

C003388

(Super. Ct. Nos. 325059 & 325061)

November 20, 1992

As Modified on Denial of Rehearings, December 18, 1992.

APPEAL from judgments of the Superior Court of Sacramento County, George E. Paras, Retired Associate Justice of the Court of Appeal, sitting under assignment by the Chairperson of the Judicial Council. Reversed.

John K. Van de Kamp, Attorney General, Timothy G. Laddish, Assistant Attorney General, Robert F. Tyler and Robert D. Milam, Deputy Attorneys General, for Defendant and Appellant.

Joanne M. Garvey, Joan K. Irion, Teresa M. Maloney, and Heller, Ehrman, White & McAuliffe, for Plaintiffs and Respondents.

Lawrence V. Brookes and Valentine Brookes as Amici Curiae for Thorn-EMI PLC and EMI Limited, on behalf of Plaintiffs and Respondents.

Jane H. Barrett, Lawler, Flex & Hall, and F. Eugene Wirwahn as Amici Curiae for the Government of the United Kingdom and the Government of Canada, on behalf of Plaintiffs and Respondents.

David F. Levi, United States Attorney, William S. Rose, Jr., Assistant Attorney General, and Gary R. Allen, David English Carmack, John J. McCarthy, and Richard A. Correa, Attorneys, Department of Justice, as Amicus Curiae for the United States of America, on behalf of Plaintiffs and Respondents.

In this case we originally concluded that California's unitary tax method of worldwide combined reporting (based on Rev. & Tax. Code, §§ 25101, 25120-25139), as applied to foreign-based unitary corporate groups, was unconstitutional under the foreign commerce clause in light of the "one-voice" component of judicially-established dormant foreign commerce clause analysis. (U.S. Const., art. I, § 8, cl. 3; *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434 [60 L.Ed.2d 336, 99 S.Ct. 1813]; *Container Corp. v. Franchise Tax Bd.* (1983) 463 U.S. 159 [77 L.Ed.2d 545, 103 S.Ct. 2933]; *Wardair Canada v. Florida Dept. of Revenue* (1986) 477 U.S. 1 [91 L.Ed.2d 1, 106 S.Ct. 2369].) In *Barclay's Bank Internat. Ltd. v. Franchise Tax Bd.* (1992) 2 Cal.4th 708, the California Supreme Court disagreed with our conclusion and remanded this matter to us. Pursuant to that remand, we have been directed to consider whether the administrative burden for a foreign-based unitary corporate group (such as exemplified by plaintiffs) in complying with worldwide combined reporting violates either the nondiscrimination component of dormant commerce clause analysis (*Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274 [51 L.Ed.2d 326, 97 S.Ct. 1076]; *Japan Line, supra*) or due process. (*Barclay's, supra*, 2 Cal.4th at pp. 742-743.) We conclude that neither of these principles is violated on "compliance burden" grounds by California's application of worldwide combined reporting to plaintiffs in the context of a properly-applied regulation (Cal. Code Regs., tit. 18, § 25137-6) governing such reporting.

BACKGROUND

When a corporation conducts business in more than one jurisdiction, either through branches or subsidiaries, the proper allocation of income for tax purposes becomes an issue. Essentially, two methods of allocating income have evolved to resolve this issue: the arm's length/separate accounting method and the unitary business/formula apportionment method. As to multinational corporations, California employs a common variant of the unitary method called worldwide combined reporting (WWCR).

Under the arm's length/separate accounting method, the various affiliated corporations of a multijurisdictional enterprise are viewed as separate from one another and the income attributable to any particular jurisdiction is determined on the basis of internal accounting records reflecting the activity of the affiliate within that jurisdiction. To preclude tax-manipulative intercorporate transfers of goods, services or other value, this accounting method requires that the tax reporting entity deal at "arm's length" with its affiliated businesses as if they were simply unrelated entities dealing in the marketplace.

In contrast, under the unitary business/formula apportionment method of accounting employed by California (WWCR), the affiliated corporations of a multijurisdictional enterprise are treated as units of a single business—that is, as a "unitary group." (Cal. Code Regs., tit. 18, § 25137-6.) If a corporation doing business in California is deemed to be part of a unitary group, the total income for that group, including corporations or affiliates operating wholly outside California or the United States for that matter, is apportioned to California by a three-factor formula. The formula takes into account property, payroll, and sales (revenue in this case) for the group in California, as a fraction of total worldwide property, payroll, and sales. (See Rev. & Tax. Code, §§ 25128-25136; Note, *State Worldwide Unitary Taxation: The foreign Parent Case* (1985) 23 Columbia Journal of Transnational Law 455, fn. 2 (hereafter 23 Columbia Journal).) The fraction is then multiplied against the unitary group's total income, producing an apportioned amount of such income taxable by California. Because intercorporate transactions are disregarded, it is unnecessary to make "arm's length" adjustments.

The present controversy involves challenges to additional tax assessments for the year 1977 resulting from California's use of WWCR. Those additional assessments were levied after the defendant California Franchise Tax Board (Board or the Board) determined that the plaintiff taxpayers, Barclays Bank of California (Barcal) and Barclays Bank International (BBI), and their ultimate corporate parent, Barclays Bank Limited (BBL), as well as the significant subsidiaries of BBI and BBL, constituted a unitary group. Barcal was directed to pay an additional $152,420 and BBI an additional $1,678. Under protest Barcal and BBI (referred to collectively as plaintiffs) paid the additional taxes and this suit ensued.

DISCUSSION

1. *The Sufficiency of Plaintiffs' Claims for Refund*

As a preliminary matter, the Board contends that plaintiffs are foreclosed from litigating the compliance burden as it relates to the commerce clause and the due process clause because these issues were not set forth in plaintiffs' claims for refund. We disagree.

The California Constitution in article XIII, section 32 provides that "[a]fter payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature." (See *Shiseido Cosmetics (America) Ltd. v. Franchise Tax Bd.* (1991) 235 Cal.App.3d 478, 486-488.) Pursuant to this constitutional authority, the Legislature has provided the procedures for seeking refunds in cases such as this one. Under Revenue and Taxation Code section 26074 (all further statutory references are to this code), a claim for refund must state the specific grounds upon which it is based. A taxpayer can bring an action only upon these grounds. (§ 26102.) In fact, courts are without jurisdiction to consider grounds not set forth in the claim. (*Atari Inc., v. State Bd. of Equalization* (1985) 170 Cal.App.3d 665, 672.) This is because the specific constitutional source of legislative power to control tax refund suits mandates strict adherence to the administrative procedures set forth by the Legislature before a court

action can be filed. (See *Shiseido Cosmetics (America), supra,* 235 Cal.App.3d at p. 488; *Patane v. Kiddoo* (1985) 167 Cal.App.3d 1207; *Woosley v. State of California* (1992) 3 Cal. 4th 758).

Here, plaintiffs did not file claims for refund as such. Instead, they filed written protests against proposed additional taxes (§ 25664) which were transformed by law into claims for refund. (§ 26078.) Under section 26078, if a taxpayer pays the protested tax before the Board decides the protest, the protest is treated as a claim for refund. Like a claim for refund, a section 25664 protest must specify the grounds upon which it is based.

The plaintiffs set forth the following grounds in their consolidated protests based on the commerce clause and due process clause:

> "The Foreign Commerce Clause of the federal Constitution and treaties prohibit application of the unitary filing to the taxpayer.
>
> "Whether the Commerce Clause of the United States Constitution limits the taxation of a unitary business to income derived from activities carried on within the United States.
>
> "Whether the Due Process . . . Clause[ ] of the United States Constitution limit[s] the application of the California method of reporting and tax to activities carried on within the United States because of arbitrary and unreasonable distortions created by including non-U.S. source income in the tax base or because the method falls unfairly on taxpayers owned by foreign affiliates whose income is used as a measure of the tax."

We think these stated grounds are sufficient to encompass the "compliance burden" issues. The protests allege that California's *method of reporting falls unfairly* on taxpayers owned by foreign affiliates. The direct implication of this language is that foreign-based unitary groups bear an unfair burden in complying with WWCR. Two decisions provide some guidance regarding the specificity required for a refund claim. In *Wallace Berrie & Co. v. State Bd. of Equalization* (1985) 40 Cal.3d 60, the court con-

cluded that a particular issue had been raised in the claim although it was set forth only indirectly. (*Id.* at p. 66, fn. 2.) In *King v. State Bd. of Equalization* (1972) 22 Cal.App.3d 1006, this court deemed a refund claim's assertion of '"erroneously and illegally' collected and computed taxes" far too diffuse to meet the specificity requirement. (*Id.* at p. 1015.) The "refund claim" here is more akin to the one in *Wallace Berrie* than to the one in *King*.

The Board spends considerable effort in arguing that this court's decision in *Shiseido* should apply here. (BSB 3-16) But that case is distinguishable. In *Shiseido*, there was *no* refund claim because the tax was paid after the protest proceedings were final and therefore the prepayment protest could not be considered such a claim. (235 Cal.App.3d at pp. 491-492; see § 26078.) In fact, *Shiseido* distinguished *Wallace Berrie* by noting that "*Wallace Berrie* has no application to this case, where there was no refund claim." (*Id.* at p. 492.)

Consequently, we conclude the plaintiffs have adequately set forth the compliance burden in the appropriate constitutional contexts. We proceed to consider that burden in the context of the commerce clause and the due process clause.

2. *The Nondiscrimination Requirement in the Complete Auto-Japan Line Dormant Commerce Clause Test*

Article I, section 8, clause 3 of the United States Constitution gives Congress the power "To regulate commerce with foreign nations, and among the several states, . . ." The commerce clause not only grants Congress the authority to regulate commerce among the states and with foreign nations, but also directly limits the power of states to discriminate against interstate or foreign commerce. (*New Energy Co. v. Limbach* (1988) 486 U.S. 269, 273 [100 L.Ed.2d 302, 308, 108 S.Ct. 1803]; *Container, supra*, 463 U.S. at p. 170.) This latter limitation is within the '"negative"' aspect of the commerce clause. (*New Energy Co., supra.*) States are prohibited from discriminating against foreign commerce in order to ensure that such commerce remains the province of federal oversight and that individual states do not work to the detriment of the nation as a whole. (*Wardair, supra*,

477 U.S. 1; see *Maryland v. Louisiana* (1981) 451 U.S. 725, 754 [68 L.Ed.2d 576, 600, 101 S.Ct. 2114].) When Congress has not acted or purported to act in a situation implicating the commerce clause, the judiciary engages in "dormant" commerce clause analysis under the "negative" aspect of the clause. (*Merrion v. Jicarilla Apache Tribe* (1982) 455 U.S. 130, 154-155 [71 L.Ed.2d 21, 40, 102 S.Ct. 894]; *Barclay's, supra*, 2 Cal.4th at p. 725, fn. 9.)

In *Japan Line, supra*, 441 U.S. 434, the "dormant" foreign commerce clause test of constitutional review was formulated. That test incorporates, among other things, the test for dormant interstate commerce clause review. (*Id.* at pp. 444-445.) The latter test upholds a state tax against an interstate commerce clause challenge if the tax '"[i] is applied to an activity with a substantial nexus with the taxing State, [ii] is fairly apportioned, [iii] does not discriminate against interstate commerce, and [iv] is fairly related to the services provided by the State.'" (441 U.S. at pp. 444-445, 449, 454, quoting *Complete Auto Transit, supra*, 430 U.S. at p. 279.) Our concern is with the discrimination component of this test.

The California Supreme Court decided in *Barclay's* that a dormant foreign commerce clause analysis was unnecessary, concluding that Congress in effect had acted and decided not to prohibit states from applying the WWCR unitary tax method to foreign-based unitary corporate groups. (2 Cal.4th at pp. 741-742.) Taking a general view, then, it is unnecessary to engage in dormant commerce clause analysis here. However, viewing the issue more specifically, the court in *Barclay's* carefully focused on the components peculiar to the dormant foreign commerce clause analysis, especially the one-voice component. The *Barclay's* court did not address, as did the trial court, the discrimination component incorporated from the dormant interstate commerce clause test of *Complete Auto* into the dormant foreign commerce clause test of *Japan Line*. For that reason, we will consider the merits of the discrimination issue as applied to plaintiffs.[1]

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[1] In its remand, the court in *Barclay's* stated: "Our holding does not end the matter, however. The trial court held that the cost to a foreign-

The principles which guide our analysis are culled largely from decisions involving the effect of state taxes on interstate commerce. *Japan Line's* incorporation of the interstate commerce clause discrimination component validates its use in the foreign commerce context. (See also *Container, supra,* 463 U.S. at p. 170.)

Under that component, a state may not impose a tax which discriminates against foreign commerce either by providing a "direct commercial advantage" to domestic commerce or by subjecting foreign commerce to multiple taxation.[2] (*Portland Cement Co. v. Minnesota* (1959) 358 U.S. 450, 458 [3 L.Ed.2d 421, 427, 79 S.Ct. 357]; *Maryland, supra,* 451 U.S. at p. 754; *Boston Stock Exchange v. State Tax Comm'n* (1977) 429 U.S. 318, 329 [50 L.Ed.2d 514, 97 S.Ct. 599]; see *Kraft Foods v. Iowa Dept. of Rev.* (1992) 505 U.S. ___ [120 L.Ed.2d 59, 65, 67-68; 112 S.Ct. 2365].) A state discriminates against foreign commerce if it imposes a burden on that commerce which is not imposed on domestic or in-state commerce, or if it favors domestic/in-state commerce without a comparable favor for foreign commerce. (*Kraft Food, supra,* 120 L.Ed.2d at p. 68; *American Trucking Associations, Inc. v. Larson* (3d Cir. 1982) 683 F.2d 787, 798, fn. 10.) A finding that a state tax discriminates may be made on the basis of either discriminatory purpose or discriminatory effect. (*Bacchus Imports, Ltd. v. Dias* (1984) 468 U.S. 263, 270 [82 L.Ed.2d 200, 208].)[3]

based unitary enterprise of furnishing financial data required by the Board's use of the worldwide formula apportionment method—the so-called 'compliance burden'—violated due process. In addition, it held that same burden violated the nondiscrimination requirement of the four-part dormant interstate commerce clause analysis under *Complete Auto Transit, Inc. v. Brady, supra,* 430 U.S. 274. [¶] The Court of Appeal explicitly declined to decide the due process issue and does not appear to have passed directly on the nondiscrimination issue. The due process issue is a fact-dependent question that should be decided by the Court of Appeal in the first instance; moreover, we think its examination of the issue would profit from a consideration of its merit free of the view that a dormant foreign commerce clause analysis is appropriate in the circumstances present here." (2 Cal.4th at p. 742.)

[2] In the compliance burden context presented here, there is no issue of multiple taxation. (See also *Container, supra,* 463 U.S. at pp. 189-193.)

Foreign-based corporate groups incur greater administrative costs to comply with California's WWCR system than do their domestic-based counterparts. In a nutshell, this distinction between domestic and foreign-based multinationals is a result of the following: while domestic-based multinationals keep most of their records in English, in United States currency and in accord with United States accounting and tax accounting principles, the same cannot be said for multinationals based abroad. (See Comptroller General Report, *Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving,* 3, GAO/GGD-82-38 (1982), p. 39.) For the foreign parent, some of the information may not be available because different nations use different accounting methods. (See 23 Columbia Journal, p. 471.) The information that does exist is not always in the language, in the currency, and in accord with the accounting principles just noted. Significant costs are incurred in obtaining the necessary information on a worldwide basis, and translating

[3] The recent United States Supreme Court decision in *Kraft Foods* did not hold that the "direct commercial advantage" principle enshrined in interstate commerce clause analysis (see *Portland Cement Co., supra,* 358 U.S. at p. 458) is irrelevant in the foreign commerce clause discrimination context. Instead, *Kraft* rejected the claim that since Iowa businesses do not receive a commercial advantage over foreign commerce under Iowa's tax system, that system does not violate the discrimination component of the foreign commerce clause test. (120 L.Ed.2d at pp. 65, 67-68.) As the court in *Kraft* noted: "[W]e think that a State's preference for domestic commerce over foreign commerce is inconsistent with the Commerce Clause even if the State's own economy is not a direct beneficiary of the discrimination. As the absence of local benefit does not eliminate the international implications of the discrimination, it cannot exempt such discrimination from Commerce Clause prohibitions." (*Id.* at p. 68.)

Following up this theme, the court in *Kraft* reiterated that if Iowa's tax statute "does not favor business activity in the United States generally over business activity abroad . . . this would indeed suggest that the statute does not discriminate against foreign commerce." (120 L.Ed.2d at p. 68.)

and transforming it to these modes. (See Comment, *California's Corporate Franchise Tax: Taxation of Foreign Source Income?* (1980) 20 Santa Clara L.Rev. 123, 143-144; 23 Columbia Journal at p. 471.)

The question is whether this distinction in "compliance burden" comprises an unconstitutional discrimination against plaintiffs. We conclude it does not.

The California WWCR unitary tax method does not discriminate against foreign-based unitary groups by providing a "direct commercial advantage" to in-state/domestic-based unitary groups. Under that method, both groups are treated the same—they face the same tax rate and must furnish the same kind of information. (Rev. & Tax. Code, §§ 25101, 25120-25138; Cal. Code Regs., tit. 18, § 25137-6.) It is well-settled that a multijurisdictional enterprise "'must pay its way'" regarding state taxation. (See 9 Witkin, Summary of Cal. Law (9th ed. 1989) Taxation, § 64, p. 84 and cases cited therein.) Therefore, a foreign-based multijurisdictional enterprise, in complying with a particular jurisdiction's taxation scheme, must always present its tax information in the language, currency and accounting principles the authorities in that jurisdiction understand. This does not constitute a *direct* commercial advantage to unitary groups based in that jurisdiction. At most, it constitutes an indirect cost inherent in doing business in *foreign* lands.

It is argued that domestic-based unitary groups, as opposed to foreign-based groups, must already compile the information required by the California WWCR tax method to comply with federal tax laws. This, however, does not render the WWCR method unconstitutionally discriminatory. Discrimination against foreign-based commerce entails imposing a burden on such commerce which is not imposed on domestic-based commerce, or favoring domestic commerce without a comparable favor for foreign commerce. (*Kraft Food, supra,* 120 L.Ed.2d at p. 68; *American Trucking, supra,* 683 F.2d at p. 798, fn. 10.) Under California's WWCR tax method, no burden is imposed on foreign-based commerce which is not imposed on domestic-based commerce and no favor is granted domestic commerce which is denied to foreign commerce. *American Trucking* illustrates this

point well. In that case, a Pennsylvania statute requiring that all motor carriers be periodically inspected was challenged on interstate commerce clause grounds. The plaintiffs argued that the statute discriminated against out-of-state motor carriers because Pennsylvania motor carriers "were already subject to" a state inspection program. (*Ibid.*) The court disagreed, noting that no discriminatory burdens were imposed on out-of-state carriers and no discriminatory favors were granted Pennsylvania carriers. (*Ibid.*)[4] In any event, the constitutionality of California's WWCR tax method must be examined on its own—its constitutionality cannot depend on the "shifting complexities" of the federal tax laws. (See *Armco Inc. v. Hardesty* (1984) 467 U.S. 638, 644-645 [81 L.Ed.2d 540, 547].)

Moreover, cost of compliance has not traditionally been thought of as constitutionally-determinative in the commerce clause context. As noted in *Bibb v. Navajo Freight Lines* (1959) 359 U.S. 520 [3 L.Ed.2d 1003], "Cost *taken into consideration with other factors* might be relevant in some cases to the issue of

[4] *Hunt v. Washington Apple Advertising Comm'n* (1977) 432 U.S. 333 [53 L.Ed.2d 383], cited by the trial court, is distinguishable in this respect. In that case, a North Carolina statute was invalidated as an unconstitutional discrimination against out-of-state commerce. The statute required all closed containers of apples sold in North Carolina to display either the applicable U.S.D.A. grade or no classification. State grades were expressly prohibited. This requirement was *inconsistent* with the practice of Washington state apple growers whose containers were preprinted with a state grade classification that was at least the equivalent of, and in many cases superior to, the U.S.D.A. grade. (432 U.S. at pp. 336-337.) The discrimination resulted from the fact that North Carolina apple producers, unlike their Washington competitors, were not forced to alter established marketing practices in order to comply with the statute. (432 U.S. at p. 351; see *American Trucking, supra,* 683 F.2d at p. 798, fn. 10.) By contrast, both foreign-based multinationals and domestic-based multinationals are saddled with the same kind of burden in complying with California's WWCR tax method because they must both furnish the same kind of information. In line with the principle enunciated in *American Trucking,* it does not matter that domestic-based multinationals are "already subject to" a procedure for which they must gather this information.

burden on commerce." (*Id.* at p. 526, emphasis added; see also *Raymond Motor Transportation, Inc. v. Rice* (1978) 434 U.S. 429, 445 [54 L.Ed.2d 664, 677]: "The regulations substantially increase the cost of [interstate movement of goods], a fact which is not... entirely irrelevant.") Although *Bibb* and *Raymond* involved highway safety regulations where compliance costs may weigh less in the balance (see *Brotherhood v. Chicago, R. I. & P. R. Co.* (1968) 393 U.S. 129, 140 [21 L.Ed.2d 289, 297-298]), the two decisions illustrate that administrative costs of compliance, alone, are generally insufficient to be deemed an unconstitutional burden. (See *Bibb, supra,* at p. 526; *Brotherhood, supra,* at p. 140.) It is one thing to invoke cost of compliance *as a factor* bearing on the risk of foreign retaliation, such risk itself being only a factor in determining whether foreign policy is implicated under the "one-voice" component of dormant foreign commerce clause analysis. (See *Container, supra,* 463 U.S. at p. 195.) It is quite another thing to invoke administrative cost of compliance as the single determinant of unconstitutional discrimination against foreign-based unitary groups.

In *Northwestern States Portland Cement Company v. Minnesota, supra,* 358 U.S. 450, the court upheld, against a commerce clause challenge, a state tax law that levied taxes on that portion of an out-of-state corporation's net income earned from business activities that were within the taxing state but exclusively in furtherance of interstate commerce. (358 U.S. at pp. 452, 461-463.) Justice Frankfurter, in dissent, believed the law unconstitutionally burdened interstate commerce in part because "there are thousands of relatively small or moderate size corporations doing exclusively interstate business spread over several States. To subject these corporations to a separate income tax in each of these States means that they will have to keep books, make returns, store records, and engage legal counsel, all to meet the divers and variegated tax laws of forty-nine States,... This will involve large increases in bookkeeping, accounting, and legal paraphernalia to meet these new demands. The cost of such a far-flung scheme for complying with the taxing requirements of the different States may well exceed the burden of the taxes themselves, ..." (*Id.* at p. 474.) Although the majority opinion did not explicitly address Justice Frankfurter's point on cost of compliance, that opinion did note that the tax at issue did not "discriminate against nor subject [the] corporation[s] to an undue burden," and that "[i]n this type of case the taxpayers must show ... a burden upon interstate commerce in a constitutional sense. This they have failed to do." (*Id.* at pp. 461, 463.)

In determining whether a tax law imposes a "discriminatory burden" on foreign commerce (see *Boston Stock Exchange, supra,* 429 U.S. at p. 331), how the law works in its "practical operation" rather than its label or appearances will control the decision. (*Nippert v. Richmond* (1946) 327 U.S. 416, 425, 431 [90 L.Ed. 760, 765, 769]; 9 Witkin, Summary of Cal. Law, *supra,* Taxation, § 65, p. 85.) As stated in *Nippert,* "Not the tax in a vacuum of words, but its practical consequences for the doing of interstate commerce in applications to concrete facts are our concern." (327 U.S. at p. 431.) Plaintiffs argue that "literal compliance" with the WWCR tax method is cost-prohibitive. In light of the principle set forth in *Nippert,* however, this argument loses much of its force. The application of the WWCR method to unitary businesses with foreign country operations is guided by California Code of Regulations, title 18, section 25137-6. Under that regulation, the Board, in computing the income and the apportionment formula factors for a combined report, "shall consider the effort and expense required to obtain the necessary information. In appropriate cases, such as when the necessary data cannot be developed from financial records maintained in the regular course of business, the ... Board may accept reasonable approximations;" moreover, taxpayers can seek "advance determination[s]" under any provision of the regulation.[5] Here, the record shows that the plaintiffs and the Board used these provisions and that computations based on reasonable approximations were made. Practically-speaking, therefore, the plaintiffs did not have to "comply literally." Applying the concrete facts here, it is evident that "literal compliance" is a "label" or "appearance" not controlling to the relevant practical determination involving the

[5] At trial, the parties and the court used the term "literal compliance" to mean the application of the WWCR regulation (section 25137-6) without the relief clauses of "reasonable approximations" and "advance determination." (§ 25137-6, subds. (e)(1) and (e)(2).)

commerce clause in this case. In any event, the evidence showed that "literal compliance" was cost-prohibitive for domestic-based unitary corporate groups as well. The domestic-based and foreign-based groups therefore stand on relatively equal footing regarding "literal compliance." Consequently, such compliance cannot serve as a *discriminatory* burden against the foreign-based groups.[6]

In short, the burden for plaintiffs in complying with California's unitary tax method of WWCR did not involve "the type of differential tax treatment" that results in an unconstitutional discrimination under the foreign commerce clause test set forth in *Complete Auto* and *Japan Line*. (See *Commonwealth Edison Co. v. Montana* (1981) 453 U.S. 609, 618 [69 L.Ed.2d 884, 894].)[7].

3. *The Due Process Clause*

In this context, there are two issues relating to "compliance burden": first, whether the WWCR administrative cost of compliance to plaintiffs is unreasonable, undue or arbitrary; and second, whether the WWCR compliance process is without reasonably adequate standards to guide enforcement. At trial, the focus was on the second issue.

Largely for the reasons expressed in our discussion above, we cannot say the WWCR administrative cost of compliance to

[6] This "practical operation" focus does not foreclose a tax law being invalidated as discriminatory on its face. (*Memphis Steam Laundry v. Stone* (1952) 342 U.S. 389, 395 [96 L.Ed. 436, 441]; see *Bacchus Imports, Ltd., v. Dias, supra*, 468 U.S. at p. 268.) California's unitary tax method of WWCR does not discriminate on its face against foreign-based corporate groups. (See Cal. Code Regs., tit. 18, § 25137-6.)

[7] In a recent case our Supreme Court used the *Complete Auto* discrimination test to hold that California discriminated against interstate commerce by imposing higher license fees on out-of-state vehicles and by imposing higher use taxes on vehicles purchased from private parties in other states. (*Woosley v. State of California, supra*, 3 Cal 4th 781, 783.) The *Woosley* court found this discrimination to be a patent violation of the commerce clause. (*Id.* at pp. 778, 781.) As we have explained above, no such discrimination is implicated here.

plaintiffs is unconstitutionally unreasonable, undue or arbitrary. (See *Portland Cement, supra*, 358 U.S. at pp. 452, 461, 463, 474.) There is no evidence in the record that a nonarbitrary application of the section 25137-6 WWCR regulation results in such a cost.

As for the second issue, the trial court stated as follows: "Plaintiffs claim that because an element of the WWCR [Cal. Code Regs., tit. 18, § 25137-6] calls for materiality, reasonable approximations, and advance determinations, all at the unfettered discretion of [the Board], with no guidelines, there is a violation of the due process clauses (both U.S. and California) insofar as the tax relates to a foreign multinational. [¶] The WWCR regulation [§ 25137-6] is not on its face uncertain, nor does the approximation segment make it uncertain. Its taxing rules are sufficiently clear and understandable to satisfy due process. The discretionary advance determination, reasonable approximation, and materiality rules (materiality does not really belong in this thought—it is inherent and essential in every tax scheme) are only there to the extent a taxpayer seeks to avail himself of them. They are not imposed willy-nilly. [¶] What does constitute a due process violation is the fact that all witnesses agreed that with customarily and currently available accounting data, literal compliance with WWCR requirements is impossible for foreign multi-nationals such as Plaintiffs, and the only way to 'comply' is by supplication and negotiation (absent an unduly burdensome cost of compliance). There is no reasonable certainty and no judicial reason to believe that whatever the taxpayer considers reasonable or material will be so treated by the [Board]. . . . [¶] Thus I conclude that WWCR as applied to Plaintiffs violates due process, both federal and state. (C.F. *Chy Lung v. Freeman* (1876) 92 U.S. 275; *Grayned v. Rockford* (1972) 408 U.S. 104; *McDonnell Douglas Corp. v. Franchise Tax Bd.* (1968) 69 C2 506)."

We agree with the trial court that California Code of Regulations, title 18, section 25137-6 (hereafter, section 25137-6) is not on its face uncertain and that its taxing rules are sufficiently clear and understandable to satisfy due process. We disagree with the trial court that section 25137-6 violates due process by allowing

"unfettered discretion" in the tax authorities in the wake of "literal compliance." We conclude the regulation can be construed to contain constitutionally-adequate standards to guide application.[8]

[8] Section 25137-6 provides in pertinent part: "(1) Unitary Business. A taxpayer is engaged in a unitary business (or a single business within the meaning of Reg. 25120(b)) when its activities within the state contribute to or are dependent upon its activities without the state. A unitary business exists when there is unity of ownership, unity of operation and unity of use.

"(2) Translation Method for Determining Income. The translation method to be used for determining income shall be the 'profit and loss method' as set forth in this regulation. . . .

"(3) General Applicability of UDITPA Regulations. The general regulations for UDITPA, Regs. 25120-25139, inclusive, shall be applicable except as otherwise provided in this regulation.

"(b) Determination of income.

"(1) The income of a unitary business with operations in foreign countries shall be computed in the following manner:

"(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

"(B) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

"(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required under Division 2, Part 11 of the Revenue and Taxation Code.

"(D) The profit and loss statement of each branch or corporation, whether U.S. or foreign, shall be translated into the currency in which the parent company maintains its books and records in accordance with subsection (b)(4).

" . . .

"(2) In lieu of the procedures set forth in subsection (b)(1) and subject to the determination of the Franchise Tax Board that it reasonably reflects income, a unitary business with operations in a foreign country may determine its income on the basis of the consolidated profit and loss statement prepared for the related corporations of which the unitary business is a member which is prepared for filing with the Securities and Exchange Commission. If the business is not required to file with the Securities and Exchange Commission, the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor may be used.

(C) No adjustment shall be required under subsections (b)(3)(A) [accounting adjustments] and (b)(3)(B) [tax accounting adjustments] unless it is material. Whether an adjustment is material depends upon the facts and circumstances of the particular case, including the amount of the adjustment, its size relative to the general level of the corporation's total assets and annual profit or loss, the consistency with which the practice has been applied, and whether the item to which the adjustment relates is of a recurring or a nonrecurring nature.

" . . .

"(e) Application of Regulation.

"(1) In computing the income and any of the factors required for a combined report, the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information. In appropriate cases, such as when the necessary data cannot be developed from financial records maintained in the regular course of business, the Franchise Tax Board may accept reasonable approximations.

"(2) A taxpayer may request an advance determination under subsections (b)(2) [consolidated SEC/shareholder profit and loss statement], (b)(3)(C) [materiality], (c)(1) [exchange rates], (d)(1) [computation of property factor] or any other provision of this regulation by submitting a determination request to the Legal Division of the Franchise Tax Board. Such a determination shall be made on an individual basis and shall be limited to the particular facts or circumstances set forth in the determination request. The facts and circumstances upon which a determination is made remain subject to review. Failure to request or to obtain a favorable advance determination will not preclude consideration of requested variances in subsequent proceedings."

"Administrative regulations are subject to the same rules of construction and interpretation that apply to statutes." (*Organization of Deputy Sheriffs v. County of San Mateo* (1975) 48 Cal.App.3d 331, 341.) So long as the regulation was properly adopted and does not transgress its statutory derivation, it " 'comes before the court with a presumption of correctness and regularity.' " (*L.A.J., Inc. v. State Bd. of Equalization* (1974) 38

Cal.App.3d 549, 553; see *Parfums-Corday, Inc. v. State Bd. of Equalization* (1986) 187 Cal.App.3d 630, 636.)

Nevertheless, to pass muster under the federal and state due process clauses, a regulation must provide reasonably adequate standards to guide enforcement. (*Fisher v. City of Berkeley* (1984) 37 Cal.3d 644, 702; *Britt v. City of Pomona* (1990) 223 Cal.App.3d 265, 278.) Government regulation must be sufficiently clear so that it is understandable and does not encourage arbitrary and discriminatory application. (*Chalmers v. City of Los Angeles* (9th Cir. 1985) 762 F.2d 753, 757; *Grayned v. City of Rockford* (1972) 408 U.S. 104, 108 (33 L.Ed.2d 222, 227); *Morrison v. State Board of Education* (1969) 1 Cal.3d 214, 231, fn. 30.) A statute, and hence a properly-adopted regulation, will not be held void for uncertainty if any reasonable and practical construction can be given its language. (*Fletcher v. Western National Life Ins. Co.* (1970) 10 Cal.App.3d 376, 405; see *California Housing Finance Agency v. Elliott* (1976) 17 Cal.3d 575, 594.) Vagueness is less a concern if an enterprise has the ability to clarify the meaning of an economic regulation in advance by resort to an administrative process. (*Chalmers, supra,* 762 F.2d at p. 757; *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.,* (1982) 455 U.S. 489, 498 [71 L.Ed.2d 362].)

The central concern here involves subsection (e) of section 25137-6, entitled "Application of Regulation" and providing: "(e)(1) In computing the income and any of the factors required for a combined report, the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information. In appropriate cases, such as when the necessary data cannot be developed from financial records maintained in the regular course of business, the Franchise Tax Board may accept reasonable approximations. [¶] (2) A taxpayer may request an advance determination under any . . . provision of this regulation by submitting a determination request to the Legal Division of the Franchise Tax Board. Such a determination shall be made on an individual basis and shall be limited to the particular facts or circumstances set forth in the determination request. The facts and circumstances upon which a determination is made remain

subject to review. Failure to request or to obtain a favorable advance determination will not preclude consideration of requested variances in subsequent proceedings."

The trial court held that with "literal compliance" in the wings, "[t]here is no reasonable certainty and no judicial reason to believe that whatever the taxpayer considers reasonable or material will be so treated by the [Board]," and that "the only way to 'comply' [with the WWCR method] is by supplication and negotiation." We disagree and conclude that the discretion vested in the Board under section 25137-6 to accept reasonable approximations and to make materiality and advance determination decisions is subject to reasonably adequate standards to guide enforcement as that regulation is interpreted herein.

Initially, we must consider the relevance of "literal compliance" in this case in its factual and legal contexts. The evidence here showed that "literal compliance" was more an abstraction than a matter of how the WWCR method was actually applied. Plaintiffs and the Board used reasonable approximations and readily-accessible corporate documents in the WWCR process. Plaintiffs' cost in filing under the WWCR system in the 1970's was shown to be relatively modest.[9] And there is no evidence the Board arbitrarily (as opposed to mistakenly) applied section 25137-6 to plaintiffs.

The legal context invoked here concerns the multijurisdictional allocation of income. It is long-since settled that a multijurisdictional enterprise "must pay its way" to each jurisdiction contributing to the flow or derivation of value. (See 9 Witkin, Summary of Cal. Law, *supra,* Taxation, § 64, p. 84.) The difficult task is how to assign a particular value to a particular jurisdiction for tax

[9] For BBI, on the order of $900 to $1,250 per year for three annual tax returns filed in the 1970's. In 1977, the tax year in question, BBI was engaged in business directly or through its approximately 70 subsidiaries in 55 countries. These tax return filing fees do not encompass BBL which, in addition to owning BBI and BBI's subsidiaries, owned 140 additional subsidiaries and operated in 5 additional countries. Thus, in 1977, BBI and its subsidiaries comprised approximately one-third the total number of subsidiaries within the BBL unitary group.

purposes. Although the general premise of "paying one's own way" is widely-accepted and intuitively-sound, the application of this premise graphically exemplifies the old adage that the "devil is in the details." As stated in *International Harvester Co. v. Evatt* (1947) 326 U.S. 416, 422 [91 L.Ed. 390, 395], "this Court has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities . . . and has declared that 'rough approximation rather than precision' is sufficient." Our Supreme Court, in *McDonnell Douglas, supra,* 69 Cal.2d at p. 511, echoed this theme by quoting from *El Dorado Oil Works v. McColgan* (1950) 34 Cal.2d 731, 741, as follows: " 'No method of allocation can precisely determine the amount of income attributable either to any given geographic area or to any given part of a series of business transactions culminating in the realization of a profit, and "any effort" in that regard "must be more or less arbitrary and fictitious" [citation] as a matter of practical tax administration.' " Finally, as the court in *Container* recognized, "Both geographical accounting [i.e., separate accounting] and formula apportionment [i.e., WWCR] are imperfect proxies for an ideal which is not only difficult to achieve in practice, but also difficult to describe in theory." (463 U.S. at p. 182.)

It is these factual and legal recognitions that make "literal compliance" less relevant and practical administrative discretion more significant in the WWCR due process equation presented here. (See also *Amoco Production Company v. Arnold* (Kan. 1974) 518 P.2d 453, 464 ["the allocation and apportionment of the income of a multistate corporation is a subject for administrative expertise in accord with statutory direction"]; Wahrhaftig, *Allocation Factors in Use in California* (1960) 12 Hastings L.J. 65, 92.) In this way, "literal compliance" cannot be considered the overriding factor of whether the due process clause has been violated in this case; however, the Board must still be subject to reasonably adequate standards to guide its application of the factors in section 25137-6 regarding reasonable approximation, materiality and advance determination. (*Fisher, supra,* 37 Cal.3d at p. 702; *Britt, supra,* 223 Cal.App.3d at p. 278.) As we construe that section, those standards are present.

Under section 25137-6, subsection (e)(1), the Board, in computing the income and the factors required for WWCR, must consider the effort and expense for the taxpayer in obtaining the necessary information. In appropriate cases, the Board may accept reasonable approximations "such as when the necessary data cannot be developed from financial records maintained in the regular course of business." (*Ibid.*) It is this mandatory consideration of effort and expense against the backdrop of data development from regularly-maintained documents that circumscribes the Board's discretion under section 25137-6 and provides a framework for meaningful judicial review if the Board arbitrarily exercises that discretion. As the-regulation notes, examples of these regularly-maintained documents include profit and loss statements filed with the Securities and Exchange Commission or profit and loss statements prepared for shareholders and subject to review by independent auditors. (§ 25137-6, subd. (b)(2).) In light of these examples, we find that section 25137-6 does not contemplate an intricate, time-consuming and expensive data development process. In short, the Board must consider the cost and effort of producing WWCR information in deciding whether to accept reasonable approximations, and that consideration is to use regularly-maintained or other readily-accessible corporate documents as the cost guideline. Given this, we also find that a court can determine, on a principled basis, whether the Board is acting arbitrarily in refusing to use reasonable approximations or in requesting certain information, information that can be compared easily to these generally-understood records. (See *Fisher, supra,* 37 Cal.3d at p. 703; on the general issue of judicial review in the administrative tax proceeding context, see *People ex. rel. Franchise Tax Bd. v. Superior Court* (1985) 164 Cal.App.3d 526, 545-546; *Aronoff v. Franchise Tax Board* (1963) 60 Cal.2d 177, 179-180; see also *California v. Grace Brethren Church* (1982) 457 U.S. 393, 417 [73 L.Ed.2d 93, 112].)

It must also be noted that the Board's discretion takes place in the application of an apportionment formula that the court in *Container* described as "something of a benchmark against which other apportionment formulas are judged." (463 U.S. at p. 170.) And the statutory basis of section 25137-6, Revenue & Taxation Code section 25137, is itself built on a "reasonable" foundation

subject to the Board's discretion; this discretion was validated in the *McDonnell Douglas* decision. (69 Cal.2d at pp. 511-512.)

Nor is the standard of "reasonable," in the context presented here, so formless as to constitute a violation of due process. "Reasonable" is a standard peppered throughout the law, and is an appropriate standard in the context of multijurisdictional allocation of income arising from expansive, complex business activities. In this context, " 'rough approximation rather than precision' " has been deemed sufficient, and any effort in this regard has been recognized to " 'be more or less arbitrary and fictitious' . . . as a matter of practical tax administration." (*International Harvester Co., supra,* 329 U.S. at p. 422; *McDonnell Douglas Corp., supra,* 69 Cal.2d at p. 511.) In the tax arena, the United States Supreme Court has upheld against a due process vagueness challenge a tax conviction premised on the standard of a " 'reasonable allowance for salaries' " for business deduction purposes. (*United States v. Ragen* (1942) 314 U.S. 513, 524 [86 L.Ed. 383, 390].) The Court noted that "[d]etermination of allowable deductions by reference to a standard of 'reasonableness' is not unusual under federal income tax laws," and that such a standard, even applied in a (proper) penal context, is not too vague to afford a practical guide to permissible conduct. (*Id.* at pp. 522-523; see also Note, *The Void-For-Vagueness Doctrine In The Supreme Court* (1960) 109 U.Pa.L.Rev. 67.)

In fact, the system plaintiffs advocate employs a standard akin to reasonable approximation. The federal system of separate accounting determines and allocates income to related businesses in a multijurisdictional enterprise by estimating what transaction costs would be incurred were the companies unrelated and dealing at arms-length. (26 U.S.C. § 482.) Indeed, tax authorities are given broad discretion to make these determinations. (*Dolese v. C.I.R.* (10th Cir. 1987) 811 F.2d 543, 546; *Peck v. C.I.R.* (9th Cir. 1985) 752 F.2d 469, 471-472.) These determinations will not be overturned unless they are shown to be arbitrary, capricious, or unreasonable. (*Ibid.*) Plaintiffs argue that 26 U.S.C. section 482, unlike the WWCR procedure, does not encompass a tax system based entirely on approximations. But the section 482 process goes to the heart of the federal income tax system for related

businesses by allocating the income, deductions, credits or allowances for the respective businesses to prevent evasion of taxes or to reflect income clearly. (26 U.S.C., § 482; *Peck, supra,* at p. 471.) In this way, both WWCR and section 482 significantly use approximations to determine income.

Finally, there is no evidence here that the Board arbitrarily applied the reasonable approximation standard while dangling plaintiffs over the "literal compliance" flame. There is evidence the Board made a mistake in the approximating process, but the Board and plaintiffs were working substantively in that process. The trial court cautioned that "[b]ureaucratic mistakes and excesses are always possible." That is true. But it is also true that such mistakes and excesses can be remedied through administrative or judicial review. As previously noted, the Board's discretion regarding reasonable approximations is circumscribed and guided by our interpretation of section 25137-6(e)(1)'s mandatory consideration of cost and effort. (See *Grayned v. City of Rockford, supra,* 408 U.S. at p. 108; *Morrison v. State Board of Education, supra,* 1 Cal.3d at p. 231, fn. 30; *Fisher v. City of Berkeley, supra,* 37 Cal.3d at p. 702.)

We conclude the Board's "reasonable approximations" discretion is subject to reasonably adequate standards to guide application and therefore is not unconstitutional under the state or federal due process clause. (*Fisher, supra,* 37 Cal.3d at pp. 702-703; *Britt, supra,* 223 Cal.App.3d at p. 278.)

That brings us to the Board's discretion regarding materiality determinations. The question of materiality asks whether certain differences—generally regarding different accounting or tax accounting practices—are material or immaterial to the overall tax computation. (See § 25137-6, subds. (b)(1)(B), (b)(1)(C), (b)(2)(A), (b)(3)(C).) As the trial court rightfully acknowledged, the concept of materiality is inherent and essential in every tax scheme. Section 25137-6 sets forth specific guidelines for materiality determinations. Under the regulation, "[W]hether an adjustment is material depends upon the facts and circumstances of the particular case, including the amount of the adjustment, its size relative to the general level of the corporation's total assets and annual profit or loss, the consistency with which the practice

has been applied, and whether the item to which the adjustment relates is of a recurring or a nonrecurring nature." (§ 25137-6, subd. (b)(3)(C).) As with reasonable approximations, the Board's discretion in determining whether something is material cannot be made arbitrarily or capriciously. (See *Chalmers, supra,* 762 F.2d at p. 757; *Grayned, supra,* 408 U.S. at p. 108; *Morrison, supra,* 1 Cal.3d at p. 231, fn. 30.) There is no reason to believe that will occur in light of these provisions guiding that discretion. We conclude the Board's "materiality" determinations are subject to reasonably adequate standards to guide application and therefore are not unconstitutional under the state or federal due process clause. (*Fisher, supra,* 37 Cal.3d at p. 702; *Britt, supra,* 223 Cal.App.3d at p. 278.)

The third challenged area of Board discretion concerns "advance determination." Under section 25137-6, subsection (e)(2), "[a] taxpayer may request an advance determination under . . . any . . . provision of this regulation by submitting a determination request to the Legal Division of the Franchise Tax Board. Such a determination shall be made on an individual basis and shall be limited to the particular facts or circumstances set forth in the determination request. The facts and circumstances upon which a determination is made remain subject to review. Failure to request or to obtain a favorable advance determination will not preclude consideration of requested variances in subsequent proceedings."

The problem for plaintiffs on this issue is that an avenue of advance administrative determination usually undermines rather than supports a due process challenge for uncertainty or unfettered discretion. (See *Chalmers, supra,* 762 F.2d at p. 757; *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., supra,* 455 U.S. at p. 498.) This is particularly true here where the avenue is so wide. Under subsection (e)(2), the taxpayer may request an advance determination under any provision of the regulation and the Board is obligated to act substantively on that request. Moreover, subsection (e)(2) provides that "[f]ailure to request or to obtain a favorable advance determination will not preclude consideration of requested variances in subsequent proceedings." The Board's discretion is tempered by this provision

since the taxpayer can raise the point again. And the Board's discretion regarding the meaning of or decisions on "reasonable approximations" and materiality is tempered by this advance determination option.

The cases relied upon by plaintiffs and the trial court in this respect are either distinguishable or compatible with our reasoning. The statute invalidated in *Chy Lung v. Freeman* (1876) 92 U.S. 275 [23 L.Ed. 550] gave the California Commissioner of Immigration the power " 'To satisfy himself whether or not any passenger who shall arrive in the State by vessels from any foreign port or place (who is not a citizen of the United States) is lunatic, idiotic, deaf, dumb, blind, crippled or infirm, and is not accompanied by relatives who are able and willing to support him, or is likely to become a public charge, or has been a pauper in any other country, or is from sickness or disease (existing either at the time of sailing from the port of departure or at the time of his arrival in the State) a public charge, or likely soon to become so, or is a convicted criminal, or a lewd or debauched woman;' " and to prohibit any such person from landing unless financial arrangements, in many cases accruing to the benefit of the Commissioner, were made. (23 L.Ed. at p. 551.) As the *Chy Lung* court noted, "[i]t is hardly possible to conceive a statute more skillfully framed, to place in the hands of a single man the power to entirely prevent vessels engaged in a foreign trade, say with China, from carrying passengers, or to compel them to submit to systematic extortion of the grossest kind." (*Ibid.*) In *Joseph Burstyn, Inc. v. Wilson* (1952) 343 U.S. 495 [96 L.Ed. 1098] and similar cases, the authorities were vested with significant discretion in sensitive areas such as free speech or free assembly. (See Note, *The Void-For-Vagueness Doctrine, supra,* 109 U.Pa.L.Rv. at p. 82, fn. 78.) For example, in *Burstyn,* a statute was invalidated that allowed a government censor to ban a film if he concluded it was "sacrilegious." (343 U.S. at p. 506.) Section 25137-6, as we have construed it, does not involve the unbridled discretion or subjective power in sensitive areas exemplified in *Chy Lung* and *Burstyn.*

In its due process analysis, the trial court also cited the decisions in *Grayned v. City of Rockford, Supra,* and *McDonnell*

Douglas Corp. v. Franchise Tax Bd., Supra. We too have relied on these decisions and they are compatible with our reasoning: *Grayned* because it is the widely-cited decision which sets forth the basic principle (in construing an anti-noise penal ordinance) that to prevent arbitrary and discriminatory enforcement, laws must provide explicit standards for those who apply them; and *McDonnell Douglas* because it illustrates the soundness of broad but rationally-guided administrative discretion in the inherently muddled area of multijurisdictional tax allocation. (See also Wahrhaftig, *Allocation Factors* in *Use* in *California*, 12 Hastings L.J., *supra*, at p. 92; *Amoco Production Co. v. Armold, supra*, 518 P.2d at p. 464.)

Indeed, it is the contexts exemplified in *Grayned* and *McDonnell Douglas* which distinguish the final case upon which plaintiffs rely: *Weissinger v. Boswell* (1971) 330 F.Supp. 615. On due process grounds, the court in *Weissinger* invalidated an Alabama statute that granted tax officials wide discretion in the setting of ad valorem assessment rates—the officials were permitted to use rates ranging from 0 to 30 percent of fair market value. (*Id.* at pp. 619, 625.) The court noted that a reasonable degree of certainty and definiteness is required in a tax statute. (*Id.* at p. 624.)

The *Weissinger* principle regarding a reasonable degree of certainty is sound and we have interpreted the "compliance burden" portion of section 25137-6 with its view in mind. Nevertheless, the context in which that principle is applied must be considered. "The degree of vagueness that the Constitution tolerates—as well as the relative importance of fair notice and fair enforcement—depend in part on the nature of the enactment." (*Hoffman Estates, supra*, 455 U.S. at p. 498.) In *Weissinger*, the challenged tax was on real property. Real property is tangible, unmovable, solely within one sovereign jurisdiction for tax purposes, and capable of precise administration. These attributes, by contrast, comprise almost the antithesis of the tax system we encounter here. As the court in *Container* aptly put it, "[b]oth geographical accounting [i.e., separate accounting] and formula apportionment [i.e., WWCR] are imperfect proxies for an ideal which is not only difficult to achieve in practice, but also difficult to describe in theory." (463 U.S. at p. 182.) At this stage in the

debate, all thoughtful people agree that multijurisdictional enterprises have to pay their way in their respective jurisdictions. And everyone agrees that geographical accounting or formula apportionment are the only two general methods available to determine the amount to be paid. It is in this inherently imprecise context, then, that we must apply the due process principles on vagueness as they pertain to administrative burden.

CONCLUSION

We emphasize the narrow scope of our decision. We have concluded that the administrative burden to plaintiffs in complying with WWCR in the context of a proper application of the WWCR regulation, section 25137-6, violates neither the nondiscrimination component of dormant commerce clause analysis set forth in *Complete Auto* and *Japan Line* nor state or federal due process. As part of our compliance burden analysis in the due process context, we have concluded that the discretion vested in the Board under section 25137-6 to accept "reasonable approximations" and to make materiality and advance determination decisions is subject to reasonably adequate standards to guide application as that regulation is interpreted herein. There is no evidence in the record that the Board applied these aspects of section 25137-6 to plaintiffs in an arbitrary, discriminatory or unreasonable way. Consequently, these aspects of section 25137-6, as applied to plaintiffs, did not violate due process.

DISPOSITION

The judgment is reversed and the trial court is directed to enter a judgment for Board. Each party shall bear its own costs on appeal.

DAVIS, J.

We concur:

PUGLIA, P.J.

SPARKS, J.

APPENDIX E

Third Appellate District No. C003388
S019064

IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA
IN BANK

BARCLAYS BANK INTERNATIONAL LIMITED ETC.,
Respondent
v.
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Appellant.

Respondent's petition for review DENIED.

Kennard, J. is of the opinion the petition should be granted.

LUCAS
Chief Justice

Filed February 18, 1993

Robert Wandruff, Clerk
Deputy

APPENDIX F

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

UNITED STATES CONSTITUTION

Article I, Section 8, Clause 3 of the United States Constitution (the Commerce Clause) provides that:

> The Congress shall have power... [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

Article VI, Clause 2 of the United States Constitution (the Supremacy Clause) provides that:

> The Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the contrary notwithstanding.

Amendment XIV, Section I of the United States Constitution (the Due Process Clause) provides:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law.

CALIFORNIA REVENUE AND TAXATION CODE

§ 25101. When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120). However, any method of apportionment shall take into account as income derived from or attributable to sources without the state, income derived from or attributable to transportation by sea or air without the state, whether or not the transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country.

If the Franchise Tax Board reapportions net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to it the basis upon which its reapportionment has been made.

§ 25137. If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting;

(b) The exclusion of any one or more of the factors;

(c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

APPENDIX G

RULE 29.1 LIST
BARCLAYS' LESS THAN 100% OWNED SUBSIDIARIES

Subsidiary	Ownership Interest
Europe Asia Dynamic Fund Management Co. SA	70.00%
Barclays Pizano Y Recoder	55.00%
Puget-Mahe SA	97.00%
Comigestion SA	97.00%
Puget-Mahe Contrepartie SA	97.00%
Massey-Ferguson Leasing Ltd.	75.00%
NB Geotech Finance Ltd.	51.00%
Fiatagri Finance Ltd.	51.00%
Barmac (Estates) Ltd.	50.10%
Blocksite Ltd.	50.20%
Bramingham Park Ltd.	50.10%
Chadacre Developments Ltd.	50.10%
Charmtape Ltd.	50.10%
Growlimit Ltd.	50.10%
J.V. Developments Ltd.	50.10%
Loopbeam Ltd.	50.10%
Mervest (Hendon) Ltd.	70.00%
Mervest (Sloane) Ltd.	51.00%
PSA Credit Company Ltd.	50.01%
Regmore Developments Ltd.	50.20%
Regmore Homes Ltd.	50.10%
Royco Business Parks Ltd.	50.10%
Wates-Barclays-Mercantile Homes Ltd.	50.01%
Wadham Stringer Credit Company Ltd.	75.00%
Barclays Motor Finance Ltd.	75.00%
Barclays Motor Wholesale Pty. Ltd.	75.00%
Barclays Bank of Botswana Ltd.	74.86%
Barclays Pensions Management Consultants (Pty.) Ltd.	74.86%
Barclays Bail SA	99.99%
Barclays Gestion SA	99.99%
Barclays Immobilier SARL	99.95%
Barclays Invest Ltd.	99.00%
Barclaymur SA	99.90%
Financiere Laffitte	99.99%
Laffitte Capital	99.99%
Laffitte Patrimoine	99.97%
Laffitte Gastion	99.80%
Laffitte Investissement	99.99%
Laffitte Securities SA	99.99%
S.A.G.O.	99.83%

Subsidiary	Ownership Interest
S.C. Des Garages du 21 Rue Laffitte	57.50%
Lutetia Societe Financiere SA	99.94%
Soc de credit Pour acquisition et amelioration des Immeubles	99.98%
S.F.G.C. (Group Barclays)	99.99%
Immogestion Barclays SA	95.04%
Society Civile Immobiliere Barclays IMMO-Hexagone	99.93%
Card Finanz Systeme AG	84.99%
Barclays Bank of Ghana Ltd.	60.00%
Barclays Bank of Ghana Forex Bureau Ltd.	60.00%
Barclays Bank of Kenya Ltd.	68.50%
Barclays Advisory and Services Ltd.	68.50%
Barclays (Kenya) Nominees Ltd.	68.50%
Barclays Merchant Finance Ltd.	68.50%
Spread Eagle Services Limited	68.50%
Barclays Bank of Serra Leone Ltd.	60.00%
Barclays Bank S.A.	91.22%
BARGES SA	91.22%
Ruval SA	91.22%
Segunda Banlid de Inversion Immobiliaria SA (SEBANSA)	91.22%
Barclays Leasing SA	91.22%
Barclays Entidad De Financiacion, SA	91.22%
Terbansa, SA	91.22%
Barclays Correduria de Seguros SA	91.22%
Barclays Bank of Swaziland Ltd.	60.00%
Barclays Bank of Uganda Ltd.	51.00%
Barclays Bank of Uganda (Foreign Exchange Bureau) Ltd.	51.00%
Barclays Bank of New York, NA[1]	99.90%
Societe d'Exploitation et de Gestion Immobiliere au Zaire	51.25%
Barclays Bank of Zimbabwe Ltd.	70.00%
Barclays Vie S.A.	99.99%
Barclays Zimbabwe Nominees (Pvt) Ltd.	70.00%
Barclaytrust (Pvt) Ltd.	70.00%
Claydon Holdings, Inc.	95.00%
Claydon Properties, Inc.	95.00%

[1] Barclays Bank of New York, N.A. has a number of 100 percent owned subsidiaries, not listed here.

APPENDIX H

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

BARCLAYS BANK INTERNATIONAL LTD., et al.,
Plaintiffs and Respondents,
v.
FRANCHISE TAX BOARD
of the State of California,
Defendant and Appellant.

No. S019064
3 Civ. No. C003388
(Consolidated with 3 Civ. No. C003389)

After Decision by the Court of Appeal
Third Appellate District

Sacramento County Superior Court Nos. 325059 and 352061
The Honorable George E. Paras, Judge Pro Term

BRIEF AMICUS CURIAE OF THE UNITED STATES IN SUPPORT OF PLAINTIFFS AND RESPONDENTS

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IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA

BARCLAYS BANK INTERNATIONAL LTD., et al.,
Plaintiffs and Respondents,
v.
FRANCHISE TAX BOARD
of the State of California,
Defendant and Appellant.

No. S019064
3 Civ. No. C003388
(Consolidated with 3 Civ. No. C003389)

AMICUS CURIAE BRIEF OF THE UNITED STATES IN SUPPORT OF PLAINTIFFS AND RESPONDENTS BARCLAYS BANK INTERNATIONAL LTD., AND BARCLAYS BANK OF CALIFORNIA

ISSUE PRESENTED

Whether California's utilization of the worldwide unitary apportionment formula method of allocating income among multinational corporations engaged in foreign commerce in order to determine the taxable income of members of a foreign owned multinational group of corporations is unconstitutional in that it interferes with the Federal Government's conduct of foreign affairs in violation of the Foreign Commerce Clause.

INTEREST OF THE UNITED STATES

The power to regulate foreign commerce is reserved exclusively to the United States. Further, the Federal Executive has exclusive authority to conduct the foreign affairs of the United States, and pursuant to that authority can agree with foreign nations as to the norms and practices with respect to international commerce among nations. States may not engage in any practice which expressly conflicts with any act of the United States in these areas, or even implicates the United States' regulation of foreign commerce and conduct of foreign policy. In short the states may

not impair the right of the United States to speak with "one voice" in conducting and controlling foreign relations and international commerce.

This *amicus curiae* brief is submitted by the United States to protect that interest. It is the position of the United States that California's worldwide unitary income allocation method of taxation may not constitutionally be applied to the taxpayers (plaintiffs-respondents) without impairing the ability of the United States to speak with one voice in conducting and controlling foreign relations and international commerce.

STATEMENT

The instant case involves California's application of the worldwide unitary apportionment formula method of allocation of income to a unitary business group consisting of a foreign parent corporation and its subsidiaries. The California Franchise Tax Board interprets California law (Cal. Rev. & Tax. Code Secs. 230001 *et seq.*), and the regulations promulgated thereunder[1] to require that taxation of the income of corporations doing business in California, if the corporations are determined to be engaged in a "unitary" worldwide business enterprise, be measured by the worldwide income of the foreign parent and all of its subsidiaries, even those which are not domiciled and do no business in the United States. California first began to so measure income of unitary business groups in 1972. (CT. 1738.)[2]

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[1]California's statutes do not expressly provide for the allocation of income of related corporations on the basis of the worldwide unitary business concept method, but rather this method of allocation of income has been adopted by the California Franchise Tax Board in enforcing and administering California's corporate tax statutes. This method of taxation is designated as the "WWCR" (Worldwide Combined Reporting) method in the opinion of the Court of Appeal.

[2]"CT." references are to the record in the trial court as paginated by the clerk of the trial court which the parties have stipulated can be used as the record on this appeal.

a. *The implication of applying the worldwide unitary apportionment formula in the Federal Government's conduct of foreign policy.*

Income of multinational corporations has been identified and allocated to taxing jurisdictions by two different methods: (1) the worldwide combined reporting unitary method utilized by California and by several other states, and (2) the international standard, the separate accounting or "arm's length" adjustment method.[3] It is the expressed policy of the United States that the separate accounting or "arm's length" method is the appropriate method of allocating income among commonly controlled multinational corporations. (CT. 1740-1742.) This view has been adopted in the United States Internal Revenue Code (26 U.S.C., Section 482)[4] and is embodied in virtually all bilateral tax treaties that have been entered into by the United States. (CT. 1742.)[5] The

[3]The transactional or geographical basis of taxation is commonly called the "arm's length" method of taxation because the taxpayer corporation is treated as a unit doing business with every other corporation and entity on an "arm's length" basis even though the other corporations are parents, subsidiaries or sister corporations. This method is designated as the "AL/SA" (Arms Length/Separate Accounting) method in the opinion of the Court of Appeal.

[4]Section 482 of the Internal Revenue Code was amended by Section 1231(e) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, to provide that income from transfers of intangibles between related parties was to be "commensurate with the income attributable to the intangible." The Department of the Treasury and the Internal Revenue Service have advised the Department of Justice that their "study" or "White Paper" on transfer pricing concludes that this amendment is fully consistent with the arm's length standard. See, *A Study of Intercompany Pricing*, prepared jointly by Department of Treasury and the Internal Revenue Service, October 18, 1988.

[5]The United States has bilateral income tax treaties with 40 nations: Income Tax Treaty with Australia, May 14, 1953, T.I.A.S. No. 2880; Income Tax Treaty with Austria, October 25, 1956, T.I.A.S. No. 3923; Income Tax Treaty with Barbados, December 31, 1984, T.I.A.S. No. 11090; Income Tax Treaty with Belgium, July 9, 1970, T.I.A.S. No. 7463; Income Tax Treaty with Canada, August 16, 1984, T.I.A.S.

No. 11087; Income Tax Treaty with Cyprus, March 19, 1984, T.I.A.S. No. 98-32; Income Tax Treaty with Denmark, May 6, 1948, T.I.A.S. No. 1854; Income Tax Treaty with Finland, December 30, 1990, S. Exec. Rept. No. 101-11; Income Tax Treaty with France, November 24, 1978, T.I.A.S. No. 9500; Income Tax Treaty with the Federal Republic of Germany, September 17, 1965, T.I.A.S. No. 5920; Income Tax Treaty with Greece, February 20, 1950, T.I.A.S. No. 2902; Income Tax Treaty with Hungary, February 12, 1979, T.I.A.S. No. 9560; Income Tax Treaty with Iceland, May 7, 1975, T.I.A.S. No. 8151; Income Tax Treaty with India, December 18, 1990, S. Exec. Rept. 101-5; Income Tax Treaty with Indonesia, December 30, 1990, S. Exec. Rept. 100-22; Income Tax Treaty with Ireland, September 13, 1949, T.I.A.S. No. 2356; Income Tax Treaty with Italy, April 17, 1984, T.I.A.S. No. 11064; Income Tax Treaty with Jamaica, May 21, 1980, T.I.A.S. No. 10207; Income Tax Treaty with Japan, March 8, 1971, T.I.A.S. No. 7365; Income Tax Treaty with Korea, June 4, 1976, T.I.A.S. No. 9506; Income Tax Treaty with Luxembourg, December 18, 1962, T.I.A.S. No. 5726; Income Tax Treaty with Malta, March 21, 1980, T.I.A.S. No. 10567; Income Tax Treaty with Morocco, August 1, 1977, T.I.A.S. No. 10195; Income Tax Treaty with the Netherlands, April 29, 1948, T.I.A.S. No. 1855; Income Tax Treaty with the Netherlands Antilles, October 23, 1963, T.I.A.S. No. 5665; Income Tax Treaty with New Zealand, November 2, 1983, T.I.A.S. No. 10772; Income Tax Treaty with Norway, December 3, 1971, T.I.A.S. No. 7474; Income Tax Treaty with Pakistan, July 1, 1957; T.I.A.S. No. 4232; Income Tax Treaty with People's Republic of China, October 22, 1986, S. Exec. Rept. 99-7 and S. Exec. Rept. No. 99-15; Income Tax Treaty with Poland, October 8, 1974; T.I.A.S. No. 8486; Income Tax Treaty with Republic of the Philippines, October 1, 1976; T.I.A.S. No. 10417; Income Tax Treaty with Romania, December 4, 1973, T.I.A.S. No. 8228; Income Tax Treaty with Spain, November 21, 1990, S. Exec. Rept. 101-16; Income Tax Treaty with Sweden, March 23, 1939, T.I.A.S. No. 958; Income Tax Treaty with Switzerland, May 24, 1951, T.I.A.S. No. 2316; Income Tax Treaty with Trinidad and Tobago, January 9, 1970, T.I.A.S. No. 7047; Income Tax Treaty with Tunisia, December 26, 1990, S. Exec. Rept. 99-13 and S. Exec. Rept. No. 101-9; Income Tax Treaty with the USSR, June 20, 1973, T.I.A.S. No. 8225; Income Tax Treaty with the United Arab Republic, August 24, 1980, T.I.A.S. No. 10149; Income Tax Treaty with the United Kingdom, December 31, 1975, T.I.A.S. No. 9682.

In particular, Article 9(1) of the United States-United Kingdom convention provides:

"arm's length" is the international norm. That standard has been adopted by international organizations that have addressed transfer pricing issues including the United Nations and the Organization for Economic Cooperation and Development (OECD).[6] Virtually every major industrial nation relies on the arm's length standard in transfer pricing cases. (Letter at 1.)[7]

Application by states of the worldwide combined unitary method of taxation conflicts directly with this federal policy and international standard. The conflict between this state practice and federal policy is clearly articulated in the November 8, 1985, statement of President Reagan on this subject.[8] President Reagan's statement demonstrates the Federal Executive's determination that the state taxing practice in question should be curtailed either by the states themselves, by the judiciary or if necessary by federal legislation. Further, in this statement the President instructed the Attorney General to ensure that this policy and the

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1. Where an enterprise of a Contracting State is related to another enterprise and conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, then any income, deductions, receipts, or outgoings which would, but for those conditions, have been attributed to one of the enterprises but by reason of those conditions have not been so attributed, may be taken into account in computing the profits or losses of that enterprise and taxed accordingly.

[6]See Organization for Economic Co-operation and Development Committee on Fiscal Affairs, *Transfer Pricing and Multinational Enterprises* (1979); *United States Model Double Taxation Convention between Developed and Developing Countries*, Commentary to Article 5 (1980).

[7]A copy of the letter to Governor Deukmejian of California, dated January 30, 1986, from Secretary of State George P. Schultz is contained in Appendix A, *infra*. This letter was entered into evidence in this case by stipulation of the parties dated September 9, 1986. (Stip. 46(h).)

[8]A copy of the statement is attached hereto as Appendix B, *infra*, and has been entered into evidence in these cases by stipulation of the parties dated September 9, 1986. (Stip. 36(a).)

interest of the United States were represented in appropriate legal cases.

In letters dated January 30, 1986, to the governors of six states of the United States which employ the worldwide unitary method of taxation (Alaska, California, Idaho, Montana, New Hampshire and North Dakota) from the Secretary of State, George P. Schultz, the United States has informed the governors that the state's employment of worldwide unitary method of tax accounting is at odds with the position the United States has taken in the conduct of foreign affairs, and has become a source of conflict with foreign nations. (Letter.)

That the utilization of the unitary method of allocation of income interferes with the conduct of foreign policy is graphically demonstrated by the fact that the Ambassadors of Australia, Belgium, Canada, Denmark, France, the Federal Republic of Germany, the United Kingdom, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands and Switzerland in a diplomatic note have advised the United States that the unitary method of taxation constitutes "a serious obstacle to the further development of our trade and investment relationships." (Letter at 2.) In addition, the Parliament of the United Kingdom in July, 1985, adopted legislation providing for retaliation against United States corporations which operate in the worldwide unitary tax states. This legislation denies parent corporations doing business in states which employ the unitary tax method tax credits on the taxes they pay to the United Kingdom on account of dividends paid in England by their subsidiaries and imposes substantial penalties on them.[9] These credits reflect the income taxes the United Kingdom subsidiaries pay with respect to the income they distributed as dividends. These credits are provided for under the United States-United Kingdom bilateral income tax convention. The United Kingdom has not yet invoked this legislation, but its

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[9]United Kingdom Finance Bill, Clause 27, adopted by the House of Commons July 10, 1985, House of Commons Official Report. Parliamentary Debates (Hansard) 1014-18 (10 July 1985). See also Letter at 3. That legislation contains a provision making possible the retroactive imposition of heavy penalties.

enactment is a clear indication of the adverse impact of the unitary method of taxation on the conduct of foreign economic relations by the United States. The filing of an *amicus curiae* brief in these cases in the courts below on behalf of the United Kingdom and the arguments against the unitary tax method made in those briefs are additional evidence of the negative impact of the California unitary tax system on the conduct of foreign policy by the United States.

b. *The application of the worldwide unitary apportionment formula to the taxpayers in these consolidated cases.*

The plaintiffs involved herein are Barclays Bank International, Limited (BBI) and Barclays Bank of California (Barcal). During the tax year in question (1977) BBI, a corporation organized under the laws of the United Kingdom, operated an international banking business in a number of countries including the United States (Appellant Br. 3.)[10] BBI was during the period in issue a wholly owned subsidiary of Barclays Bank Limited, also a corporation organized under the laws of the United Kingdom. *(Ibid.)*[11] BBI operated directly in California and as such was subject to regulation by the State of California. Barcal was a California banking corporation, a wholly-owned subsidiary of BBI during the tax years at issue, doing a general retail banking business only in California. *(Ibid.)* As plaintiffs were doing business in California they were subject to taxation by the United States and the State of California.

For the tax year 1977 Barcal filed a tax return with the Franchise Tax Board which reported all the income it earned which was only from California sources and thus fully taxable by California. This return was based upon the separate accounting method and hence none of its income was apportioned. BBI filed a return for the year 1977 with the Franchise Tax Board which reported not only the income BBI earned from California sources

[10]"Appellant Br." references are to pages in Appellant's Opening Brief on this appeal.

[11]In 1985 BBI and Barclays Bank Limited merged under the laws of the United Kingdom to form Barclays Bank PLC.

but also included: (1) income BBI earned from operating bank agencies and branches in the United Kingdom and approximately 33 nations or territories outside of the United Kingdom, including California; and (2) the income earned by 70 subsidiaries of BBI which operated in 34 nations or territories outside of the United Kingdom. (Appellant Br. 3.) BBI's California tax return was based upon the worldwide combined reporting method, and the income reported thereon was apportioned to California using the three-factor formula method as applicable to banks. (Appellant Br. 3.)

The California Franchise Tax Board upon audit of these returns determined that Barcal and BBI were members of a worldwide unitary business conducted by all members of the Barclay Group which included: (1) Barcal, a wholly-owned subsidiary of BBI doing business only in California; (2) BBI, a United Kingdom Corporation doing general retail and commercial banking in the United Kingdom and 34 other nations or territories outside the United Kingdom, including California; (3) the subsidiaries of BBI in which BBI has more than a 50% interest; (4) Barclays Bank Limited, a United Kingdom corporation which conducts no business in California and which owns 100 % of the stock of BBI; and (5) the subsidiaries of Barclays Bank Limited in which that corporation holds more than a 50% interest. (Appellant Br. 3-4.) The California Franchise Tax Board then calculated BBI's and Barcal's tax by allocating a portion of the total income of the above unitary group to these two taxpayers utilizing a three-factor apportionment formula.

Under the three-factor apportionment formula, the in-state corporation's income is calculated as a percentage of the total income of the group of related corporations. After the unitary business group is identified, the in-state corporation's sales, property, and payroll are expressed as a fraction of the total sales, property, and payroll of the unitary group; these three fractions are arithmetically averaged, and this average when multiplied against worldwide group income, yields the taxable income of the in-state corporation. Thus, the apportionment to the in-state corporation of a percentage of the total income of the unitary group is a mathematical function of the income of the total

unitary business group, including those members of the unitary business group operating outside the taxing state.

Utilizing the above method of taxation, proposed tax assessments were issued. (Appellant Br. 5.) The taxpayers claimed this taxation to be improper as it was based not only on their income but also on the income of their foreign parent and upon the income of other foreign subsidiaries of their parent who do not do business in California or elsewhere in the United States. These taxpayers protested the proposed assessments to the Franchise Tax Board, and thereafter paid the proposed tax assessments and sued for a refund of these taxes in the California Superior Court for Sacramento County. (Appellant Br. 5.) One of the grounds raised by the taxpayers in these refund suits was that the Foreign Commerce Clause of the United States Constitution prohibited the application of the worldwide unitary business three-factor formula method for computing the income of the taxpayers. (Appellant Br. 7.)

The trial court entered a judgment and opinion in favor of the taxpayers on August 20, 1987. (CT. 1687, 1716.) This decision rested upon the trial court's conclusion that California's computation of the taxes in question using the worldwide combined unitary business group reporting and three-factor method of apportioning the business group's income to California sources was impermissible as it discriminated against foreign commerce (CT. 1751), violated due process (CT. 1755, 1756) and because it contravened the Foreign Commerce Clause of the United States Constitution as it impeded the Federal Government's ability to speak with one voice in the conduct of foreign affairs, an area wherein federal uniformity is necessary (CT. 1738, 1746, 1747, 1749, 1758-1760).

Thereafter the Franchise Tax Board appealed to the Court of Appeal of California in and for the Third Appellate District and that Court on November 30, 1990, affirmed the decision of the trial court. 255 Cal.App.3d 1342. That court held (1) there was no affirmative federal policy permitting California's use of "worldwide combined reporting" and therefore a dormant Foreign Commerce Clause analysis was in order (Slip Opinion, pp. 23-30); (2) California's use of "worldwide combined reporting" implicated foreign policy issues which must be left to the federal government (Slip Opinion, pp. 31-41); and (3) California's use of "worldwide combined reporting" frustrated the United States' ability to speak one voice in an area of foreign affairs wherein federal uniformity was necessary, and therefore it violated the Foreign Commerce Clause. (Slip Opinion, pp. 41-52.) The Court of Appeal denied the Franchise Tax Board's timely petition for rehearing, and on February 28, 1991, this Court granted the Franchise Tax Board's petition for review.

The instant *amicus curiae* brief supports the trial court's and the Court of Appeal's conclusion that California's application of its worldwide unitary business concept and apportionment formula method of allocating income among a unitary business group controlled by a foreign parent corporation is unconstitutional under the Foreign Commerce Clause as it impairs the ability of the United States to speak with one voice in an area of foreign affairs wherein federal uniformity is necessary.

SUMMARY OF ARGUMENT

BBI, a British corporation, and its subsidiary, Barcal, a California corporation, are engaged in the banking business in California. BBI is the wholly owned subsidiary of Barclays Bank Limited, a British corporation. The California Franchise Tax Board determined that BBI and Barcal were part of a worldwide unitary business and determined their income for 1977 under the worldwide unitary method of taxation. Under that method, the income of all companies that were engaged in a unitary business, including the British parent of BBI and that parent's 50 percent owned subsidiaries that did no business in California, were combined, after eliminating intercompany transactions, to determine the net income of the unitary business. This net income was then apportioned to California on the ratio of the unitary business' California property, payroll and sales to the unitary business' total property, payroll and sales. The issue presented in this case is whether California's unitary taxation method as applied in determining the tax liability of a foreign corporation and its subsidiary that do business in California represents an unconstitutional burden upon, and interference with, foreign commerce. The Superior Court and

the Court of Appeal held, *inter alia*, that the unitary taxation method as applied in the instant cases was unconstitutional because the tax constitutes an impermissible interference in the conduct of the nation's foreign affairs. We agree and submit that that reason alone warrants affirmation of the judgment of the Court of Appeal below.

Under the Commerce Clause of the United States, a state may not, when imposing an income-based tax, tax value outside its border. The state may, however, constitutionally tax on an apportioned basis the total income and property of a corporation earning income in, and moving its property through, multiple taxing jurisdictions. The test for constitutionality of a tax imposed on an apportioned basis under the dormant interstate commerce clause is: (1) there must be a substantial nexus between the state and the activity or property taxed; (2) the activity or property must be fairly apportioned to the taxing state; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. When, however, the state tax is challenged under the dormant Foreign Commerce Clause, two additional questions must be addressed to determine the constitutionality of the tax: (1) whether the tax creates a substantial risk of international multiple taxation, and (2) whether the tax prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments. Because the tax in question fails under the second test, it is unnecessary to address any other tests.

The Federal Constitution has conferred upon the Federal Government the exclusive power to represent this nation in matters of foreign affairs. The United States and its foreign trading partners have consistently used the "arm's length" standard in allocating income between nations. Although the Court, in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), upheld the constitutionality of California's worldwide unitary method of income taxation as applied to a domestic parent corporation with foreign subsidiaries, the Court reserved judgment as to whether the constitutionality of the tax would be upheld as applied to a foreign controlled corporate group, the issue presented in these cases. Unlike the *Container*

Corporation case, the Federal Government has participated in this case to demonstrate that the application of the apportionment method used by California in these cases implicates foreign policy issues and prevents the Federal Government from speaking with one voice in this very sensitive area of foreign policy. Not only has the United States indicated to other nations the standard that should be used in apportioning income and not only have its foreign trading partners agreed to this standard, but its trading partners expect all political units of the United States to abide by this standard. Its major trading partners have protested the use of the unitary method of taxation to allocate income. California's insistence upon the use of that method has seriously complicated the Federal Government's economic relations with its major trading partners. In addition, the United Kingdom has enacted retaliatory legislation. The Court in *Container Corporation* opined that the most obvious foreign policy implications of a state tax is the retaliation by foreign governments against the United States. The *Container Corporation* court further noted that the nuances of foreign policy were much more the province of the Federal Executive than the Courts and that deference was due to its views. Neither retaliatory legislation nor the Federal Executive's views were presented in that case. There can be little doubt that the apportionment method used by California in the instant case is an impediment to the Federal Government's conduct of foreign relations and is thus unconstitutional.

The Appellant argues that the dormant Foreign Commerce Clause analysis, upon which the Federal Government, the Superior Court and the Court of Appeal have relied, is irrelevant because under the principles enunciated in *Wardair Canada v. Fla. Dept. of Revenue*, 477 U.S. 1 (1986), affirmative Congressional action has by implication allowed the states great freedom in the manner in which they impose income taxes including the freedom to employ the apportionment method in issue. In support of that position, the Appellant points to the fact that the Federal Government's tax policy with its trading partners in treaties or otherwise has dealt generally with federal taxation and that the Senate explicitly refused to approve the United States-United Kingdom Tax Convention until the clause barring the use of the worldwide apportionment method was removed from the treaty.

We are unaware that either the Congress or the Executive has ever given even tacit approval to the use of that method. Indeed, even with respect to the exclusion of the clause in the United States-United Kingdom Tax Convention forbidding this method of tax apportionment, the majority of the Senate favored eliminating that method. Thus, there is hardly any federal policy that eliminates the necessity of resorting to the dormant Foreign Commerce Clause analysis to test the Constitutionality of the apportionment method in issue.

We submit that for the reasons stated above, the judgment of the Court of Appeal should be affirmed.

ARGUMENT

THE COURT OF APPEAL CORRECTLY HELD THAT THE TAX IMPOSED ON THE TAXPAYERS IN THESE CASES WAS UNCONSTITUTIONAL BECAUSE ITS APPLICATION IMPLICATED UNITED STATES FOREIGN POLICY BY PREVENTING THE UNITED STATES FROM SPEAKING WITH ONE VOICE IN CARRYING OUT ITS COMMERCIAL RELATIONS WITH FOREIGN GOVERNMENTS

A. *Controlling legal principles.*

The power to regulate foreign commerce is reserved exclusively to the United States by the Foreign Commerce Clause of Article I, Section 8, Clause 3 of the United States Constitution. Further, it has been unequivocally established that the Federal Government, primarily through the Executive Branch, possesses the sole and exclusive authority to conduct and control the foreign affairs of the United States. *Chicago & Southern Air Lines, Inc. v. Waterman Steamship Corp.*, 333 U.S. 103, 111 (1948); *United States v. Pink*, 315 U.S. 203 (1942); *United States v. Belmont*, 301 U.S. 324 (1937); *United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304, 314-316 (1936); *Oetjen v. Central Leather Co.*, 246 U.S. 297 (1918).

Under the Commerce and Due Process Clauses of the United States Constitution, a state may not impose a property or income

tax on tax values situated or earned outside its borders. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 164 (1983), rehearing denied 464 909 (1983); *Asarco, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 315 (1982). However, within the ambit of interstate commerce it has been recognized that a state may constitutionally tax on an apportioned basis the total income and property of a corporation earning income in, and moving its property through, multiple taxing jurisdictions. *Container Corp. v. Franchise Tax Board, supra* at 164; *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207 (1980); *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 444-445 (1979); *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959). The test for constitutionality of a tax imposed on such an apportionment basis on property or income of a corporation engaged in interstate commerce is: (1) there must be a substantial nexus between the state and the activity or property taxed; (2) the activity or property must be fairly apportioned to the taxing state; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1, 8 (1986); *Japan Line, Ltd., supra* at 444-445; *Container Corp., supra* at 164.[12] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

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[12]The linchpin of apportionment in the field of state income taxation is the unitary business principle. *Mobil Oil Corp., supra*. The constitutional requirements set forth above as they pertain to the unitary business/formula apportionment method of taxation require that a state not tax a unitary business unless some part of it is conducted within the state, unless there is some minimal connection between interstate activities and the taxing state, and unless there is a rational relationship between the income attributable to the in-state corporation and intrastate values of the unitary enterprise. *Container Corp., supra* at 166; *Exxon Corp., supra* at 220; *Mobil Oil Corp., supra* at 436, 437; *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). The second requirement above that the income or tax be fairly apportioned has two components: first, fairness requires internal consistency, so that if every state employs the formula the result would be that no more than all the

If the unitary business groups involved herein were only doing business in interstate commerce, the application of the unitary business concept and the apportionment formula method of taxation would not be unconstitutional. However, the plaintiffs are corporations which are members of a group controlled by a foreign parent corporation engaged in international commerce, and the above analysis of the Commerce Clause as it relates to interstate commerce is not identical to the analysis of that clause as it relates to foreign commerce. *Japan Line, Ltd., supra* at 446. The Commerce Clause as it relates to foreign commerce unequivocally reserves to the Federal Government exclusive power and jurisdiction to control and regulate foreign commerce. *Brolan v. United States*, 236 U.S. 216, 218-219 (1915). The Supreme Court in *Michelin Tire Corp. v. Wages, Tax Commissioner*, 423 U.S. 276, 285 (1976), clearly stated that state taxation cannot so impinge upon foreign policy considerations so as to prevent the United States from speaking with one voice when regulating commercial relations with foreign governments. The Supreme Court in *Japan Line, Ltd., supra* at 446-448, stated that when foreign commerce is present in a situation involving a state tax on an instrument of foreign commerce, two additional requirements are necessary for constitutionality: first, there must be no enhanced risk of multiple taxation; and second, the tax on the instrumentality of foreign commerce may not impair federal uniformity of policy where uniformity is essential. The focus of the second requirement is that the tax cannot prevent the Federal Government from speaking with one voice when regulating commercial relations with foreign governments. *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. at 8; *Container Corporation of America v. Franchise Tax Board*, 463 U.S. at 185-197. The Court in *Japan Line, Ltd.*, 441 U.S. at 451, stated that "[i]f a state tax contravenes either of those precepts, it is unconstitutional under the Commerce Clause."

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income of the unitary business would be taxed; and secondly, there must be external consistency such that the factors used in the apportionment formula reflect a reasonable sense of how the income is generated. *Container Corp.*, 463 U.S. at 169. These constitutional considerations also require that there be some bond of ownership or control uniting the purported unitary business. *Asarco, Inc., supra* at 316-317. In addition, the above principles have required that the out-of-state activities be related in some concrete way to the in-state activities; *i.e.*, that there be some sharing or exchange of value not capable of precise identification or measurement beyond the mere flow of funds arising out of passive investment. *Asarco, Inc., supra* at 317; *Mobil Oil Corp., supra* at 438-432. However, these requirements are not addressed in this brief.

Three recent Supreme Court decisions inform analysis for the resolution of the instant appeals. The first is *Japan Line, Ltd. v. County of Los Angeles, supra*. In that case, California imposed a nondiscriminatory, apportioned, ad valorem property tax on cargo containers that were instrumentalities of foreign commerce temporarily located in California ports. The containers were subjected to an unapportioned property tax in their country of domicile, Japan. The Court determined that the tax there in issue was unconstitutional because it resulted in multiple taxation of instrumentalities of foreign commerce and prevented the United States from speaking with one voice in the conduct of foreign affairs. 441 U.S. at 451-454.

With respect to the requirement that the taxation method used must not enhance the risk of multiple taxation, the Supreme Court in *Japan Line, Ltd., supra* at 446, 447, postulated certain preliminary principles. Multiple and duplicative taxation is offensive to the Commerce Clause. In order to prevent multiple and duplicative taxation states are required to impose taxes on instruments of domestic interstate commerce on an apportioned basis so that an instrumentality is subject to no more than one tax on the full value being taxed. In the interstate arena, the Court is able to enforce fair apportionment by all potential taxing jurisdictions in the United States. The Supreme Court stated that when foreign commerce is implicated in the imposition of an apportioned state tax (441 U.S. at 447-448 footnote omitted) —

> * * * neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign. If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results.

> Hence, whereas the fact of apportionment in interstate commerce means that "multiple burdens logically cannot occur," *Washington Revenue Dept.*, 435 U.S. at 746-747, the same conclusion, as to foreign commerce, logically cannot be drawn. Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though "fairly apportioned" to reflect an instrumentality's presence within the State, may subject foreign commerce " 'to the risk of a double tax burden to which [domestic] commerce is not exposed, and which the commerce clause forbids.' " *Evco v. Jones*, 409 U.S. at 94, quoting *J.D. Adams Mfg. Co.*, 304 U.S. at 311.

With respect to the second requirement that a state tax may not impair federal uniformity of policy were uniformity is essential, the Court in the *Japan Line, Ltd.* case stated (441 U.S. at 448) that:

> Second, a state tax on the instrumentalities of foreign commerce may [not] impair federal uniformity in an area where federal uniformity is essential. Foreign commerce is preeminently a matter of national concern. "In international relations with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power." *Board of Trustees v. United States*, 289 U.S. 48, 59 (1933).

The second case is *Container Corp. of America v. Franchise Tax Board, supra*, in which the Court analyzed the constitutionality of California's use of the worldwide unitary method of taxation in taxing the income of a domestic corporation, which, with its subsidiaries, did business in the United States and in foreign countries. The Court therein first analyzed the tax in question pursuant to the requirements for constitutionality of a corporate group engaged only in domestic interstate commerce, and found California's tax to be constitutionally permissible under those standards. *Container Corp., supra* at 185. Since the unitary group of corporations was doing business in foreign nations as well as in California, the Court found it necessary to examine the constitutionality of the tax in question under the two additional tests

formulated in *Japan Line* for testing the constitutionality of a state tax on an instrument or entity engaged in foreign commerce, *i.e.*, whether the tax involved an enhanced risk of double taxation, and whether the tax impaired the United States' ability to speak with one voice in an area of foreign commercial relationships where federal uniformity is necessary.

With respect to the first requirement posited in *Japan Line* under the dormant Foreign Commerce Clause, the Supreme Court in *Container Corp.* found that application of the unitary apportionment formula in taxing the income of the subsidiary of a domestic parent with foreign subsidiaries did not entail an enhanced risk of double taxation. The Court in *Container Corp.* concluded on the evidence before it that the "arm's length" method of taxation also entailed risks of double taxation in the field of foreign commerce; and since risks of double taxation were unavoidable under both alternatives, and could only be avoided by the state not taxing the group's income at all (which was unacceptable since some of the group's income was sourced in the state), application of the unitary business concept and apportionment formula was not unconstitutional by virtue of the unavoidable possibilities of double taxation. *Container Corp., supra* at 189-193. The courts below on the basis of this reasoning in *Container Corp.*, found that there was no enhanced risk of double taxation with respect to the tax imposed herein. (Slip Opinion, pp. 30-31; CT. 1750.)[13]

Next the Supreme Court in *Container Corp.* elaborated at length on the second requirement it established in *Japan Line*, to determine the constitutionality of a state tax applied to an

[13]We do not address this conclusion of the courts below. This brief emphasizes the invalidity of the application of the tax in question because the tax prevents the Federal Government from speaking with one voice in the conduct of foreign affairs and international trade. This emphasis on the second requirement in *Container Corp.* is not a concession that California's tax does not enhance the risk of double taxation, but rather is a recognition that this tax is an egregious interference with the Federal Executive's conduct of foreign affairs and is thus, patently unconstitutional.

instrumentality of foreign commerce. The Court stated (463 U.S. at 186, 194 (footnote omitted)):

> "A state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If the State imposes an apportioned tax, international disputes over reconciling apportionment formulae may arise. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. . . . . If other States followed the taxing State's example, various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speaking with one voice' in regulating foreign Commerce." [quoting *Japan Line, Ltd., supra* at 448.)
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> In conducting this inquiry, however, we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer "[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States." *Mobil,* 445 U.S. at 448. See also *Japan Line,* 441 U.S. at 456, n.20; *Michelin Tire Corp., supra,* at 286. Thus, a state tax at variance with federal policy will violate the "one voice" standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive. The second of these considerations is, of course, essentially a species of preemption analysis.

Next the Supreme Court stated (463 U.S. at 194, 195-196):

> The most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole. 441 U.S. at 450. In considering this issue, however, we are faced with a distinct problem. This Court has little competence in determining precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please.
>
> * * * *
>
> A state tax may, of course, have foreign policy implications other than a threat of retaliation. We note, however, that in this case, unlike *Japan Line,* the Executive Branch has decided not to file an *amicus curiae* brief in opposition to the state tax. The lack of such a submission is by no means dispositive. Nevertheless, when combined with all the other considerations we have discussed, it does suggest that the foreign policy of the United States — whose nuances we must emphasize again, are much more the province of the Executive Branch and Congress than of this Court — is not seriously threatened by California's decision to apply the unitary business concept and formula apportionment in calculating appellant's taxable income.

Having found this tax as applied in *Container Corp.* not to enhance the risk of double taxation, and further not to implicate foreign policy issues, the Supreme Court upheld the tax in question. However, the Supreme Court in *Container Corp.* expressly reserved judgment as to whether the constitutionality of the tax would be upheld as applied to a foreign controlled corporate group, the issue presented in this case. *Container Corp., supra* at 189, n.26, and 195 n.32.

The third case germane to the instant controversy is *Wardair Canada, Inc. v. Florida Department of Revenue,* 477 U.S. 1 (1986). In that case the State of Florida's sales taxation of all fuel purchased in Florida was challenged by a Canadian airline operating charter flights to and from the United States. The airline attacked the validity of Florida's tax statute insofar as it authorized assessment of a tax on fuel used by foreign airlines engaged exclusively in foreign commerce. The airline argued: that by the Federal Aviation Act Congress preempted the field of foreign air travel and thus left no room for local government taxation of such travel; that the tax violated the Foreign Commerce Clause of the United States Constitution and a federal policy expressed in the

Convention on International Civil Aviation of 1944 (Chicago Convention) to which Canada, the United States, and 155 other nations were parties; and that the tax was inconsistent with the Nonscheduled Air Services Agreement between the United States and Canada regulating air charter service between the United States and Canada.

The Supreme Court in *Wardair* first analyzed the preemption argument and noted that Congress through the Federal Aviation Act had regulated aviation extensively. But the Supreme Court held that state law is not automatically preempted wherever there is a federal regulation of an activity, an industry or an area of the law. The Court noted that when Congress legislates within the scope of its constitutionally granted powers, that legislation may displace state law. Whether or not there is such a preemption depends upon whether Congress intended to displace state law. If there is an actual conflict between state law and federal law then it is presumed that Congress intended preemption. Where there is no actual conflict between federal and state law, the Supreme Court has required evidence of a congressional intent to preempt the field. *Wardair Canada, Inc., supra* at 6. In *Wardair* the Supreme Court found that not only was there a lack of evidence of an intent to preempt the field but to the contrary, the Federal Aviation Act expressly permitted state sales taxation of purchases of airline fuel. Thus, there was no preemption in the carrier's favor. (477 U.S. at 7.)

With respect to the Foreign Commerce Clause argument, the Supreme Court likewise held the state tax valid. The Supreme Court first recognized that in cases where the Federal Government had not acted, it is the responsibility of the judiciary to strike down action taken by state or local authorities that unduly threatens the values protected by the Commerce Clause. *(Ibid.)* The parties in *Wardair* claimed the tax in question impaired the ability of the United States to speak with one voice in the field of foreign relations.

The Court in *Wardair* noted a special need in the area of foreign commerce for federal uniformity, citing *Board of Trustees v. United States*, 289 U.S. 48, 59 (1933), and *Japan Line, Ltd. v. County of Los Angeles, supra*. The Court stated that "In international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power." *Wardair Canada, Inc., supra* at 8. The Supreme Court in *Wardair* then reiterated the two additional requirements for testing the validity of a state tax affecting foreign commerce as posited in *Japan Line, Ltd.* to wit: whether the state tax enhances the risk of international multiple taxation; and whether the tax impairs the Federal Government from speaking with one voice when regulating commercial relations with foreign governments. (477 U.S. at 8.) In *Wardair* it was admitted that there was no threat of multiple taxation as the Florida tax was imposed solely upon the sale within the state of airline fuel. Rather the carriers contended that the tax was invalid because there existed a federal policy of reciprocal tax exemptions for the instrumentalities of international air traffic, including aviation fuel, and that this policy represents the statement that the "one voice" of the Federal Government wished to make, and this "one voice" statement was threatened by the state tax in question (*Id.* at 9.)

The Supreme Court in *Wardair* held that the various conventions and agreements cited by the parties did not evidence any such federal policy as contended by the parties but rather showed that the Federal Government had accepted and allowed state taxation of fuel purchased within the taxing states' borders. Further, the affirmative action by the Federal Government in these conventions and agreements in allowing such state taxation removed this case from the context of a dormant Foreign Commerce Clause situation in which the Federal Government had remained silent and had allowed the states to act in this area without any need for uniformity. (*Id.* at 9.) In short, rather than preempting the field in favor of the carrier, the Congress by affirmatively allowing state taxation of aviation fuel in the Chicago Convention and in the more than 70 bilateral agreements governing international aviation to which the United States was a party, had affirmatively decided to permit such state taxation. The Supreme Court in *Wardair* concluded that there was no silence on the issue which would trigger a dormant Foreign Commerce Clause analysis and there was no announced federal policy on the issue which the Florida tax contravened. Accordingly, the Florida

sales tax on aviation fuel as levied on foreign aviation carriers was upheld by the Supreme court in *Wardair.*

It is submitted that under the foregoing rationales of the Supreme Court's decisions in *Japan Line, Ltd., Container Corp.,* and *Wardair,* California's application of its worldwide unitary apportionment formula method of computing income tax is unconstitutional as applied to a unitary group of corporations controlled by a foreign parent corporation. Such an application impairs the ability of the United States to speak with one voice in the conduct of foreign commercial relations in an area where federal uniformity is necessary. Application of this tax has disrupted the foreign relations of the United States as conducted by the Federal Executive and has given rise to retaliatory legislation by one foreign nation.

B. *Under the controlling constitutional principles the instant tax as applied to the taxpayers is unconstitutional.*

The Federal Government is responsible for the formulation and implementation of the foreign policy of the United States. State statutes or practices conflicting with or impeding the Federal Government's responsibilities with respect to the foreign relations of the United States are void under the Federal Constitution.

The trial and appellate courts below, citing *Container Corp.* concluded that Congress had not enacted any statute either favoring or opposing income taxation by states of foreign nationals through application of the worldwide unitary business concept and three-factor apportionment formula. (Slip Opinion, pp. 17, 21-30; CT. 1740, 1758.)[14] Thus the courts below properly found

[14]The Court of Appeal and the trial court noted that the Federal Executive had negotiated in the 1975 United States-United Kingdom Tax Treaty a clause (Clause 9(4)) proscribing a state's use of the worldwide unitary business concept and three-factor formula in computing a foreign corporation income tax; and that this clause was inserted at the instance of the United Kingdom as a result of California's extension of the said method of income tax computation to foreign nationals. The Senate Foreign Relations Committee defeated in committee a reservation with respect to Clause 9(4) by a vote of 10 to 5. On the Senate floor

that there was no direct conflict between the state tax as applied and any federal statute or Congressional policy, hence there was no issue of preemption. (Slip Opinion, pp. 17, 21-30; CT. 1745.) Accordingly, the courts below proceeded to apply a dormant Foreign Commerce Clause Analysis to the facts of this case.

The Court of Appeal and the trial court correctly found the Federal Executive to have taken the position that California's method of computing the income tax of a member of a unitary business group owned by a foreign parent corporation should be discontinued as contrary to internationally accepted accounting standards (Slip Opinion, pp. 34, 45, 52; CT. 1741) and the international practice favoring the arm's length method of tax computation (Slip Opinion, p. 54; CT. 1749). The application of California's method of taxation in computing the tax of the taxpayers involved in this case is unconstitutional under the Foreign Commerce Clause as an impermissible interference with the Federal Government's policy and conduct of foreign relations.

The adoption by the Federal Executive of this policy is evidenced by the letter of January 30, 1986, from the Secretary of State for the United States to the Governor of California, wherein the Federal Executive advises that in the conduct of foreign affairs it has taken "the position that the 'arm's length' adjustment method of allocating income among commonly controlled corporations doing business in various national jurisdictions is the appropriate method to be employed." (Letter.) The letter further states that this view is reflected in the bilateral tax treaties to which the United States is a party. Those tax treaties provide that income attributable to "permanent establishment" in the territory

the reservation was again defeated by a vote of 46 to 34; thereafter the treaty received a favorable vote of 49 to 32, five votes short of the ⅔ vote required for advice and consent to ratification. Subsequently Clause 9(4) was reserved to without a vote and the treaty was approved with the reservation. The courts below held that these three votes favoring Clause 9(4) (one in committee and two on the Senate floor) did not evidence a Congressional policy for California's method of taxation but rather, if anything, a Congressional preference, not amounting to a policy, favoring discontinuance of California's method of taxation. (Slip Opinion, pp. 28-29; CT. 1739-1740.)

of a party will be taxed by that party on the basis of the arm's length method of apportionment. (See footnote 5, *supra.*)[15] The Internal Revenue Code also adopts this apportionment method. Moreover, this letter from the Secretary of State clearly expresses the position taken by the Federal Executive that the arm's length apportionment method is the "international standard" and "international rule" which has been adopted generally by foreign tax systems, and is prescribed in the model income tax treaties published by the Organization for Economic Cooperation and Development (OECD) and the United Nations. (Letter.) Article II of the Constitution vests the power to conduct and control the foreign affairs of the United States solely with the President of the United States and his duly appointed aides; and the Executive has the particular expertise needed to identify and assess which rules and practices are generally accepted and followed by the international community and which are not. Its determinations in such regard are entitled to very great weight by the courts. *Container Corp.*, 463 U.S. at 195. See also *Factor v. Laubenheimer*, 290 U.S. 276, 295 (1933); *Charlton v. Kelley*, 229 U.S. 447, 468 (1913).

It is the position of the United States Government, as reflected in the letter of the Secretary of State to the Governor of California, that the unitary tax is at odds with the "arm's length" accounting method which is the international rule and standard, and that adherence to the "arm's length" method of taxing corporations with foreign parents is essential to avoid adverse consequences for the foreign relations of the United States. (Letter.) Under these circumstances, state tax methods which contravene this position cannot be reconciled with the Foreign Commerce Clause of the United States Constitution. The conflict between this position adopted by the United States in the conduct

[15]Contrary to the Appellant's argument (Br. 32, n.23), there is nothing in the recent treaties departing from the arm's length method. Indeed, Article 9(3) of the Income Tax Treaty with Barbados, December 31, 1984, T.I.S.A. No. 11090, was added to make it clear that the United States retained the right to apply its inter-company pricing rules, which apply the arm's length standard. (Code Sec. 482 (of the arm's length standard)). S. Exec. Rept. 99-9, 99th Cong. 1st Sess. at 25.

of foreign relations and the California tax as applied in the instant case to taxpayers with foreign parents must, therefore, be resolved in favor of the position taken by the United States.

This conflict is precisely the type of state action which the Supreme Court in *Container Corp., supra*, found would be unconstitutional in that it prevents the Federal Government from speaking with one voice in foreign relations. Moreover, this conflict is substantial in nature, as is evidenced by the Secretary of State's letter to the Governor of California to the effect that state worldwide unitary taxes have become a source of conflict with numerous foreign governments, including those of Australia, Belgium, Canada, Denmark, France, the Federal Republic of Germany, the United Kingdom, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands and Switzerland. (Letter.) The Secretary of State concluded in his letter to Governor Deukmejian (Letter at 2) that:

> Continued state taxation on a worldwide unitary basis will greatly impair the ability of the federal government to carry out its tax and investment policy in the international arena and to manage the sensitive issue of international double taxation. The worldwide unitary issue has seriously complicated our economic relations with many of our closest allies.

Further, the conflict has resulted in the United Kingdom's enactment of retaliatory legislation. (Letter.) The Supreme Court in *Container Corp.* pointed out 463 U.S. at 194, that the most obvious interference with foreign affairs which a state tax statute could pose was offending foreign trading partners to such an extent that they might enact retaliatory legislation against the United States as a whole, but that there was no such retaliatory legislation demonstrated in *Container Corp.* The Supreme Court in *Container Corp.* stated that it had little competence in determining precisely when foreign nations will be offended by particular acts and how to balance the risk of such retaliation against the sovereign right of the United States as a whole to allow states to tax as they please. *Container Corp., supra* at 194. The letter from Secretary Schultz to Governor Deukmejian cites the United Kingdom's retaliatory legislation as one of the difficulties California's taxing method has precipitated in the conduct of foreign

affairs. (Letter at 3.) This is precisely the type of impediment to the conduct of foreign affairs which *Container Corp.* indicated would render a state tax unconstitutional. 463 U.S. at 194.

The Supreme Court further pointed out, in *Container Corp.*, 463 U.S. at 195, that a state tax could have foreign policy implications other than retaliatory legislation, but that the nuances of foreign policy are much more the province of the Federal Executive than the Supreme Court. Since the Federal Executive did not elect to file an *amicus curiae* brief in *Container Corp.*, the Supreme Court assumed that there were no substantial foreign policy considerations which the state tax in that case contravened. Therefore, it upheld the application of the tax in question there to a domestic corporation with foreign subsidiaries. *Container Corp. v. Franchise Tax Board*, 463 U.S. at 195-196.[16] *Container Corp.* involved the application of California's tax to a domestically controlled group of corporations and it was that issue on which

[16]The trial court below also held California's tax as applied to be unconstitutional as it discriminated against instruments of foreign commerce (CT. 1751-1754) and violated the Due Process Clause (CT. 1754-1756). The trial court found that each foreign nation has its own version of "generally accepted accounting principles" (GAAP), and that a foreign corporation using its own national version of GAAP is able to file an "arm's length" tax return with its own country and with the United States without any inordinate additional expenses. (CT. 1752.) However, a foreign corporation using its national version of GAAP would have to incur an inordinate expense to comply with California's income tax method involved herein. (CT. 1752, 1753.) The trial court found this inordinate expense to discriminate against foreign corporations. (CT 1753.) As an alternative to this inordinate expense the foreign corporation could seek advance rulings from the California Franchise Tax Board or could seek the Board's approval to use estimates instead of actual accounting entries. However, the trial court held that advance rulings and use of estimates was entirely at the discretion of the taxing authorities and such total discretion was a lack of due process. (CT. R. 1754-1756.) The Court of Appeal did not reach this issue as it deemed it unnecessary. (Slip Opinion, pp. 54-55.) We submit that this discriminatory treatment and lack of due process is but another facet of California's tax as applied herein which has exacerbated the Federal Executive's problems in dealing with foreign nations in this area.

the Federal Executive expressed no view. The Supreme Court in *Container Corp.*, as stated before, expressly reserved judgment on the issue in the instant case. To allay any doubts as to the Federal Executive's position on the issue herein, this *amicus* brief is being filed. Thus, this Court should have no difficulty in determining the Federal Executive's views. The statements of the Secretary of State (Letter) and of the President of the United States (Statement) demonstrate that the Federal Government has a clearly articulated policy in favor of "arm's length" accounting in the conduct of foreign affairs, and that California's worldwide combined unitary business method is in conflict with the internationally accepted standard and policies, and custom, and has caused serious disputes and difficulties for the United States in the conduct of foreign affairs. Because of these foreign policy considerations and because of their gravity, the Department of Justice, at the direction of the President, is filing this *amicus curiae* brief.

C. *Appellant's argument*

The Appellant argues (Br. 20-27) that under the rationale of *Wardair* there in affirmative Congressional action allowing California to utilize its apportionment formula in computing appellees' tax liabilities, and that this Congressional action and policy obviates the need for any dormant Foreign Commerce Clause analysis. The Appellant argues (Br. 22) that *Wardair* permitted negative implications to be drawn that the state tax in *Wardair* was permissible under federal law in two circumstances: (1) when there was a treaty restricting the national governments' abilities to tax but not restricting the subnational governments; and (2) when there were treaties restricting the power of subnational governments to enact some taxes but not restricting their power to enact other taxes. (Appellant Br. 22.) The Appellant points to the various bilateral tax treaties between the United States and foreign countries as examples of treaties restricting national governments but not subnational governments, and derives therefrom a negative inference that states are authorized by federal law to impose taxes such as the one at issue. (App. Br. 22-24.) Appellant cites the non-discrimination tax clause made applicable to the states in some of the United States' tax treaties as examples of treaties which restrict some state tax powers, but not other

state tax powers, and thus form a basis for implying that the non-banned powers are authorized as a matter of federal law. (App. Br. 26-27.) Appellant concludes that the negative implications to be drawn from the above described treaties amounts to a clear federal congressional decision authorizing the state tax method in issue, and thus, under *Wardair* negates any dormant Foreign Commerce Clause analysis under *Container Corp.* (App. Br. 20-27.)

The Court of Appeal (Slip. Op. pp. 22-30) correctly pointed out that *Wardair* provides no support for Appellant's argument. *Wardair* involved a situation wherein the plaintiff, a Canadian company engaged only in foreign commerce, claimed that Florida's imposition of a sales tax on aviation fuel purchased by the carrier in Florida was unconstitutional under the Foreign Commerce Clause as it impaired the United States' ability to speak with one voice in the conduct of foreign affairs. The Supreme Court in *Wardair*, however, decided the case against the taxpayer finding that there was an affirmative federal policy allowing such taxation. This finding was based upon the Chicago Convention, the Federal Aviation Act, and more than 70 bilateral agreements on aviation to which the United States was a party. In 1944 the United States and 156 other nations, including Canada, became signatories to the Chicago Convention. *Wardair Canada*, 477 U.S. at 10. This convention expressly addressed the sales and use tax problem on aviation fuel, and explicitly prohibited only the imposition of such taxes with respect to fuel on board a foreign carrier when it entered the taxing jurisdiction. *Ibid.* at 10. The necessary negative implication of this provision was that other local sales and use taxes on aviation fuel were not prohibited. *Ibid.* at 10. The Supreme Court in *Wardair* also pointed out that Section 1113 of the Federal Aviation Act addresses the problem of state taxation of air commerce expressly forbidding some state taxes and expressly allowing certain state taxes. *Id.* at 6. Among the permissible taxes under that statute are state sales and use taxes. *Id.* at 7. Next the Supreme Court in *Wardair* noted that after the Chicago Convention addressed the state sales tax issue in 1944, the United States entered into more than 70 bilateral aviation agreements, most of which explicitly prohibited national taxes on aviation fuel used by carriers of the other contracting

party, but none of which interdicted state taxes on such fuel. *Id.* at 11. The Supreme Court in *Wardair* held that the Chicago Convention demonstrated the United States' and the international community's awareness in 1944 of the state and local sale taxation problem with respect to aviation fuel, and the provisions of that convention represented a decision by the parties to the convention to address the problem by curtailing and limiting only some of the local taxing authorities' power to tax, thereby preserving other aspects of that local power to tax. *Id.* at 10. Further, the Supreme Court found that in the 70 bilateral aviation agreements entered into since the Chicago Convention, the United States was aware of the sales tax problem, knew of the Chicago Convention's treatment of the problem, and elected not to change that treatment but knowingly acquiesced in state sales taxation of aviation fuel. *Id.* at 12.

The Supreme Court held these knowing acts formed an affirmative decision and policy by the United States to allow sales taxation of aviation fuel. Accordingly, the Supreme Court found that the United States' position was in accord with Florida's and there was no need to resort to any dormant Foreign Commerce Clause Analysis to see if the tax in question was unconstitutional. *Id.* at 9, 13.

In advancing its argument that a dormant Foreign Commerce Clause analysis is not warranted, the Appellant contends that prior to the ratification of the United States-United Kingdom tax convention in 1978 there were numerous United States tax conventions which did not prohibit the taxation method employed herein. In finding a federal policy favoring the tax there involved, the Appellant equates these tax conventions with the 70 bilateral aviation agreements that the Supreme Court noted in *Wardair*. As the Court of Appeal correctly pointed out (Slip. Opinion, pp. 25-26), Appellant's argument overlooks one significant difference between the 70 bilateral agreements involved in *Wardair* and the tax conventions it cites here which were ratified before 1978. Although both sets of agreements are silent as to the respective state taxation involved, the 70 bilateral agreements involved in *Wardair* were entered into after the Chicago Convention had addressed specific local taxes that were precluded. There are no

foundation agreements dealing with the instant issue of state taxation to which the tax treaties can be related. Thus, as the Court of Appeals recognized (*Ibid.*), no negative inference can be drawn supporting the tax method in issue from the fact that the various United States bilateral tax treaties did not purport to restrict state taxing power. None of those treaties, except for the United States-United Kingdom, mentions the unitary tax method. Equally inapposite are the nondiscrimination clauses of the treaties of Friendship, Commerce, and Navigation because the subject matter of such clauses is so dissimilar to clauses authorizing or prohibiting a particular type of tax or tax method as were present in *Wardair.*

Moreover, as the courts below pointed out (Slip Opinion, pp. 23-24; CT. 1738), the unitary method of taxation was never a serious factor in foreign affairs until it was first applied to foreign controlled multinational corporations in 1972. Indeed, the trial court concluded that one could not realistically determine any such reaction or policy position until Appellant's expanded use of the unitary method of taxing foreign multinational corporations was felt through audits, assessments, protests and negotiations between the United States and foreign governments. (CT. 1738.) Thus, as the courts below concluded (Slip Opinion, pp. 23-24; CT. 1739, 1758-1759), the numerous tax and Commerce, Navigation and Friendship conventions in force as of 1978, which do not address the taxation issue here presented, and of which the treaty parties were not seriously concerned, are of no significance as the 70 treaties were in *Wardair.*

A further ground for rejecting the Appellant's argument that there exists a federal policy allowing the method of taxation here and thus no dormant Foreign Commerce Clause analysis is warranted, is the fact that the Supreme Court, in considering in *Container Corp.* the identical method of taxation involved herein as applied to a domestically controlled and owned unitary group of corporations doing business domestically and overseas, examined the constitutionality of the tax there in issue using a dormant Foreign Commerce Clause analysis. *Container Corp. v. Franchise Tax Board,* 463 U.S. at 185-196. If the Supreme Court in *Container Corp.* had found a Congressional policy favoring

unitary taxation of domestically owned multicorporate groups doing business overseas, that would have ended the inquiry and there would have been no need to engage in a dormant Foreign Commerce Clause analysis. But the Supreme Court expressly found no such policies and thus resorted to the dormant Foreign Commerce Clause analysis. *Container Corp. v. Franchise Tax Board,* 436 U.S. at 196. The courts below correctly interpreted *Container Corp.* as holding there is no Congressional policy either for or against such method of income taxation. (Slip Opinion, pp. 29-30; CT. 1758.)

Another ground advanced by Appellant for the existence of a federal policy permitting the tax method in issue is the fact that the Senate in 1978 approved the United States-United Kingdom Tax Convention with a reservation negating language contained in Clause 9(4) which would have barred California's tax in this case. (Appellant Br. 14-16, 25.) Both the Court of Appeal and the trial court below specifically addressed this argument and correctly found it without merit. (Slip Opinion, pp. 28-29; CT. 1739-1740.) The trial court noted that the Federal Executive had inserted Clause 9(4) in the proposed United States-United Kingdom tax convention at the insistence of the United Kingdom and that Clause 9(4) would have barred the application of the instant tax. (CT. 1739.) However, the Court of Appeal and the trial court pointed out that when a reservation to Clause 9(4) was introduced in hearings before the Senate Finance Committee on the proposed tax convention, the Committee defeated the reservation by a vote of 10 to 5; next on the Senate floor this reservation to Clause 9(4) was defeated by a vote of 44 to 34. (Slip Opinion, p. 289; CT. 1739.) On this basis the proposed tax convention was submitted to the Senate for a vote for ratification and the Senate voted 49 to 32 for ratification, 5 votes short of the ⅔ vote necessary for ratification. (Slip Opinion, p. 28.) Next the Senate reserved Clause 9(4) without a vote and the tax convention was approved with the reservation. The Court of Appeal and the trial court in their opinions expressly noted that the reservation to Clause 9(4) received a minority of votes in each of 3 votes: the vote in committee and the votes on the floor of the Senate. (Slip Opinion, p. 28; CT. 1739.) Accordingly, the courts below held that this vote represented not a vote for a policy favoring the

allowance of states to impose the worldwide combined unitary business method of income taxation, but rather represented a preference, not amounting to a policy, against such a method of income taxation. (Slip Opinion, p. 29; CT. 1740.) The Court of Appeal stated that it failed to see how three majority votes in the Senate essentially approving Clause 9(4) could be transmogrified into a Congressional of disapproval of Clause 9(4) and approval of the tax method in issue. (Slip Opinion, p. 29.) In any event, in these special circumstances of treaty making does not establish federal policy in favor of such state taxation methods. Therefore, the Court of Appeal and the trial court rejected this argument and so should this Court.[17]

In view of the foregoing it is submitted that the Court of Appeal correctly concluded that there was no affirmative federal policy permitting California's use of the tax method in issue, and that therefore the issues herein should be resolved by a dormant Foreign Commerce Clause analysis as stated in *Container Corp.* (Slip Opinion, pp. 24-30).

The Appellant argues that the Court of Appeal erred when it found that the United States Executive could be the "one voice" which established a federal policy prohibiting the tax method at issue, rather than the voice of Congress. (Appellant Br. 28-32.) Appellant maintains that the Executive cannot exercise the "one voice" in foreign affairs but only Congress can. (Appellant Br. 29). From this Appellant concludes that the Court of Appeal erred in its dormant Foreign Commerce Clause analysis by considering the Executive's actions as the United States "one voice" speaking in the conduct of foreign affairs. (Appellant Br. 29.) No statutory or case law authority is offered for this argument, and it completely ignores the long and clearly established rule that the Executive Branch conducts the foreign affairs of the United States, and if Congress has not acted in this area, actions of the Executive are the acts of the United States and represent United States' policy until Congress acts to the con-

[17]It is absurd to conclude, as does the Appellant, that three losing minority votes in the Senate against the reservation of Clause 9(4) could be the basis of a policy position of the whole Senate.

trary. *Chicago & Southern Air Lines, Inc. v. Waterman Steamship Corp., supra; United States v. Pink, supra; United States v. Belmont, supra; United States v. Curtiss-Wright Export Corp., supra; Oetjen v. Central Leather Co., supra,* see also: *Dames & Moore v. Regan,* 453 U.S. 654 at 678-684 (1981).

Appellants also argue (Br. 28-29) that the Court of Appeal erred in its dormant Foreign Commerce Clause analysis by looking to the Executive Branch for a federal directive and policy. Appellants lose sight of why the Court of Appeal looked to federal policy as expounded by the Executive Branch. That Court followed faithfully the directions of the Supreme Court in *Container Corp.,* which mandates that state taxing practices must give way if they intruded into the conduct of the foreign relations of the United States and interfered with the conduct of foreign affairs. The Court of Appeal specifically found that the tax method in question was in conflict with the norms and standards of international commerce, had offended numerous foreign countries, caused a number of disputes and problems in the United States' conduct of foreign affairs, and had led to retaliatory legislation by the United Kingdom. (Slip Opinion, pp. 32-34.)[18] The Court of Appeal then concluded (Slip, Opinion, pp. 42-45) that the Federal Executive had exercised its lawful powers in the conduct of foreign affairs in this area in order to eliminate disputes with its trading partners and that contrary state law must give way to the

[18]Appellant also argues that the conduct of foreign affairs is not significantly implicated because the retaliation by Great Britain is not justified under United States law. It is submitted that the conduct of foreign affairs is necessarily determined not by whether a foreign country's actions are justified under our law as opposed to foreign law but rather whether there is a dispute with a foreign country and what is the most efficient and beneficial manner of resolving that dispute. Accordingly, whether or not Great Britain's retaliatory legislation is or is not justified under our law is of no great moment. The fact remains that a potentially serious dispute exists with Great Britain, and retaliatory legislation by Great Britain is in place, both of which can have adverse effects on the United States' foreign commercial relations. This alone is a serious matter in the conduct of the United States' foreign affairs which must be addressed by the Federal Executive.

"One Voice" requirement of the dormant Foreign Commerce Clause Analysis. When California frustrates this "one voice" of the federal government speaking in the conduct of foreign affairs, the Foreign Commerce Clause of the United States Constitution is infringed.

CONCLUSION

For the reasons stated above, the decision below is correct and should be affirmed on the ground that the method of taxation involved is unconstitutional as it impairs the United States' ability to speak with one voice in an area where federal uniformity is essential.

Respectfully submitted,

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APPENDIX A

THE SECRETARY OF STATE
WASHINGTON

January 30, 1986

Dear Governor Deukmejian:

As you are aware, federal legislation was recently introduced with the full support of the Administration which would prohibit states from taxing corporations under the worldwide unitary method and from taxing more than an equitable share of foreign source dividends. This action was taken at the express direction of the President. I am writing to explain to you the foreign policy concerns that prompted this legislation and to urge you to act promptly to reconsider your state's use of the worldwide unitary method of taxation.

When a corporation (or related group of corporations) operates across state or national boundaries, competing tax claims of the jurisdictions in which the corporate group operates are resolved by identifying the income attributable to each jurisdiction. Two different methods are in use for making the determination with respect to transnational income: separate accounting and worldwide unitary combination. The longstanding policy of the federal government has been to follow the separate accounting method. The United States has advocated and adopted the position that the "arm's-length" adjustment method of allocating income among commonly controlled corporations doing business in various national jurisdictions is the appropriate method to be employed. This view is embodied in the Internal Revenue Code and is a central feature in our bilateral tax treaties. Separate accounting is also the international standard. It is prescribed in the model income tax treaties published by the Organization for Economic Cooperation and Development ("OECD") and the United Nations ("UN") and by foreign country tax systems

generally. In contrast, the worldwide unitary method of taxation is followed only by seven of the U.S. states. Your state's employment of the worldwide unitary method of tax accounting is at odds with the position of the United States and has become a source of conflict with foreign states.

In an environment in which separate accounting is the federal policy and the generally accepted international rule, state taxation on a worldwide unitary basis creates a clear risk of double taxation. Because labor costs and property values vary sharply on an international basis, the rates of profitability of affiliates operating within and without the jurisdiction of the unitary state are often different. Double taxation will result if the relative profitability of the investment in the unitary tax state is less than that of the affiliated overseas operations that are taxed abroad on a separate accounting basis. This risk of double taxation may distort investment decisions, thereby reducing the overall flow of investment into the United States.

Our concern over the worldwide unitary method of taxation's inhibiting effect on foreign investment in the United States is shared by many foreign governments. They have advised us of their view that "The [unitary tax] method can chill international investment and decrease efficient allocation of resources and employment opportunities. In particular, the unitary method can impede foreign entry into the United States market." They contend that the unitary method of taxation constitutes "... a serious obstacle to the further development of our trade and investment relationships." (Diplomatic note signed by the Ambassadors of Australia, Belgium, Canada, Denmark, France, Federal Republic of Germany, the United Kingdom, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, and Switzerland.)

The administration of the worldwide unitary method of taxation also imposes unreasonable and costly compliance burdens on an enterprise which is considered to be part of a worldwide unitary group. The information required by the tax authorities of the jurisdiction practicing a worldwide unitary method of taxation may not be readily available to the enterprise and, in the case of foreign-controlled entities which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S.

operations for any other reason, will require costly conversion into a form usable by the jurisdiction's tax authority.

For these reasons I believe state worldwide unitary taxation to be inappropriate. Continued state taxation on a worldwide unitary basis will greatly impair the ability of the federal government to carry out its tax and investment policy in the international arena and to manage the sensitive issue of international double taxation. The worldwide unitary issue has seriously complicated our economic relations with many of our closest allies. During my tenure as Secretary of State, this has been a difficult and long-lasting issue. The Department of State has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world. The unitary issue has been partially responsible for stalling some bilateral tax treaty negotiations.

Most seriously, the U.K. Parliament, in July, 1985, unanimously adopted anti-unitary retaliatory legislation permitting the U.K. government to deny, on a unilateral basis and retroactive to April, 1985, a very valuable benefit of the U.S.-U.K. tax treaty for U.S. corporations operating in worldwide unitary states. This legislation, by virtue of a provision which makes possible the retroactive imposition of heavy penalties, was having a chilling effect on the willingness of U.S. companies to repatriate earnings of their U.K. subsidiaries to the United States and on their willingness to claim benefits properly available to them under the treaty. While the U.K. has agreed to defer implementation of this legislation for the time being, this incident makes it clear that state worldwide unitary taxation is adversely affecting the United States' foreign economic relations.

While the Administration has proposed federal legislation prohibiting worldwide unitary taxation and limiting state taxation of foreign dividends, I would welcome swift legislative or administrative action by your state to terminate your state's use of the worldwide unitary method of taxation and to limit appropriately your state's taxation of foreign source dividends.

Sincerely yours,

George P. Shultz

APPENDIX B

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release November 8, 1985

STATEMENT BY THE PRESIDENT

Since early in this Administration, we have been working with the states, the business community, and foreign governments in an effort to resolve issues related to state use of the worldwide unitary method of taxation. At this time I believe it appropriate for the Federal Government to state its support for the *concept* of legislation that would:

1. Effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ("the water's edge requirement"), and

2. Address the question of equitable taxation of foreign source dividends.

We hoped that by this time these principles would have been enacted by the various states that have unitary taxation. Since states have not universally accepted these principles, I am instructing the Secretary of the Treasury to initiate the process of *crafting* Federal legislation to incorporate these principles into law and to work with the Congress for passage, and also, where appropriate, to enter into negotiations to amend double taxation agreements. I am also instructing the Secretary of the Treasury to pursue enactment of the domestic "spreadsheet" legislation, which has been previously proposed, and which is designed to assist nonunitary states with tax enforcement respecting multinational corporations in order to promote full taxpayer disclosure and accountability.

Further, I am instructing the Attorney General to ensure that the United States' interests are represented in appropriate controversies and cases consistent with this approach.

CERTIFICATE OF SERVICE

It is hereby certified under penalty of perjury that service of the foregoing brief amicus curiae has been made on counsel by mailing a copy to each on this ____ day of May, 1991, in envelopes, with postage prepaid, properly addressed to each of them, respectively, as follows:

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APPENDIX I

FTB Notice No. 89-714, Franchise Tax Board,
November 17, 1989.

Corporation franchise (income) — Refund claims — Deferrals of action on refund claims until outcome of pending appeal.— Deferrals of action on corporate tax refund claims will be available to taxpayers who have filed claims for refund that are limited to the question of law presented in the pending appeal of *Barclays Bank International v. Franchise Tax Board* (see ¶ 401-552 for the lower court's decision). In *Barclays*, the California Court of Appeal has been asked to decide the "one voice" issue; that is, whether, in determining the corporate tax liabilities of an entity that is part of a multinational enterprise involving a foreign parent corporation, California's imposition of the requirements of the worldwide combined reporting is consistent with the federal foreign affairs powers contained in the Commerce Clause of the United States Constitution.

No deferrals will be available for claims for refund that raise factual issues such as whether a unitary business exists or whether an individual taxpayer's cost of compliance is constitutionally impermissible; those claims will be acted upon using existing procedures.

Deferrals will be available only when the matter is in the claim status, with no action having been taken with respect to the claim. The notice outlines how this requirement applies at the audit level, the protest level, and the appeal level. A taxpayer seeking deferral of action should specify in the taxpayer's claim for deferral that the claim is limited to the "one voice" issue currently before the Third Appellate District Court in the *Barclays* case, and that the taxpayer requests deferral of action pending the outcome of that case pursuant to FTB Notice 89-714.

APPENDIX J

California Code of Regulations, Title 18

§ 25137-6. Combined Reports Including Foreign Country Operations.

(a) In General

(1) Unitary Business. A taxpayer is engaged in a unitary business (or a single business within the meaning of Reg.25120(b)) when its activities within the state contribute to or are dependent upon its activities without the state. A unitary business exists when there is unity of ownership, unity of operation and unity of use.

(2) Translation Method for Determining Income. The translation method to be used for determining income shall be the "profit and loss method" as set forth in this regulation. This method excludes unrealized exchange rate gain or loss resulting from the restatement of assets or liabilities, while taking into account exchange gains or losses attributable to income transactions.

(3) General Applicability of UDITPA Regulations. The general regulations for UDITPA, Regs. 25120-25139, inclusive, shall be applicable except as otherwise provided in this regulation.

(b) Determination of income.

(1) The income of a unitary business with operations in foreign countries shall be computed in the following manner:

(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(B) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards under Division 2, Part 11 of the Revenue and Taxation Code.

(D) The profit and loss statement of each branch or corporation, whether U.S. or foreign, shall be translated into the currency in which the parent company maintains is books and records in accordance with sub-section (b)(4).

(E) Business and nonbusiness income as determined under California law shall be identified and segregated. For general definition, rules and examples for determining business and nonbusiness income, see Regulation 25120.

(F) Nonbusiness income shall be allocated to a specific state pursuant to the provisions of Sections 25124 to 25127, inclusive of Division 2, Part 11 of the Revenue and Taxation Code.

(G) Business income shall be included in the combined report prepared for the unitary business and shall be apportioned on the basis of the appropriate formula for the business.

(H) Income from California sources shall be expressed in dollars in accordance with subsection (b)(4) and the taxes computed accordingly.

(2) In lieu of the procedures set forth in subsection (b)(1) and subject to the determination of the Franchise Tax Board that it reasonably reflects income, a unitary business with operations in a foreign country may determine its income on the basis of the consolidated profit and loss statement prepared for the related corporations of which the unitary business is a member which is prepared for filing with the Securities and Exchange Commission. If the business is not required to file with the Securities and Exchange Commission, the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor may be used.

(A) Adjustments shall be made, if necessary to:

(i) conform to the accounting principles generally accepted in the United States for the preparation of such statements, except as modified by this regulation;

(ii) conform to the tax accounting standards as required under Division 2, Part 11 of the California Revenue and Taxation Code; and

(iii) eliminate unrealized gain and losses resulting from the restatement or revaluation of assets or liabilities to reflect changes or fluctuations in currency values.

(B) Business and nonbusiness income as determined under California law shall be identified and segregated. For definitions, rules and examples for determining business and nonbusiness income, see generally Regulation 25120.

(C) Nonbusiness income shall be allocated to specific states pursuant to the provisions of Sections 25124 to 25127, inclusive of the Revenue and Taxation Code.

(D) Business income shall be included in the combined report prepared for each unitary business and will be apportioned on the basis of the appropriate formula for each business.

(E) Income from California sources shall be expressed in dollars in accordance with subsection (b)(4) and the taxes computed accordingly.

(3) For purposes of subsections (b)(1)(B), (b)(1)(C), and (b)(2)(A), the following rules shall apply:

(A) Accounting adjustments to be made to conform profit and loss statements to those utilized in the United States

(i) Include but are not limited to the following:

(I) Clear reflection of income. Any accounting practice designed for purposes other than the clear reflection on a current basis of income and expense for the taxable year shall not be given effect. For example, an adjustment shall be required where an allocation is made to an arbitrary reserve out of current income.

(II) Physical assets, depreciation, etc. All physical assets, including inventory when reflected at cost, shall be taken into account at historical cost computed either for individual assets or groups of similar assets. The historical cost of such an

asset shall not reflect any appreciation or depreciation in its value or in the relative value of the currency in which its cost was incurred. Depreciation, depletion, and amortization allowances shall be based on the historical cost of the underlying asset, and no effect shall be given to any such allowance determined on the basis of a factor other than historical cost.

(III) Valuation of assets and liabilities. Any accounting practice which results in the systematic undervaluation of assets or overvaluation of liabilities shall not be given effect, even though expressly permitted or required under foreign law, except to the extent allowable under subsection (b)(3)((B). For example, an adjustment shall be required where inventory is written down below market value.

(IV) Income equalization. Income and expense shall be taken into account without regard to equalization over more than one accounting period; and any equalization reserve or similar provision affecting income or expense shall not be given effect, even though expressly permitted or required under foreign law.

(ii) Currency gains or losses on closed transaction are includible, but no adjustments shall be made, or otherwise reflected, for unrealized gains or losses resulting from the restatement or revaluation of assets or liabilities to reflect changes or fluctuations in currency values. A closed transaction is one where any foreign exchange position taken by a corporation has been terminated by exchanging the foreign currency for the currency in which the individual corporation maintains its books and records normally conducts its business affairs. In the case of a borrowing in a foreign currency, the transaction shall not be deemed closed until repayment is made.

(B) The tax accounting adjustments to be made shall include, but are not limited to, the following:

(i) Accounting methods. The method of accounting shall reflect the provisions of Section 24651 of the Revenue and Taxation Code and the regulations thereunder.

(ii) Inventories. Inventories shall be taken into account in accordance with the provisions of Sections 24701 through 24706 of the Revenue and Taxation Code and the regulations thereunder, except Regulations 24702-24706(b)(5).

(iii) Depreciation, depletion, and amortization. Depreciation, depletion and amortization are to be computed in accordance with California law.

(iv) Elections.

(I) Elections required to be made for purposes of determining income under Division 2, Part 11 of the Revenue and Taxation Code of all California reporting entities shall be made in accordance with applicable provisions of such law and the regulations adopted pursuant thereto.

(II) Elections required to be made for purposes of determining income under Division 2, Part 11 of the Revenue and Taxation Code for entities which are not subject to taxation by California but are required to be included in the combined report for the unitary business shall be made by agreement of all entities required to report to California in accordance with applicable provisions of such law and the regulations adopted pursuant thereto. If agreement cannot be reached, such income shall be reported on the basis of United States generally accepted accounting principles.

(C) No adjustment shall be required under subsections (b)(3)(A) and (b)(3)(B) unless it is material. Whether an adjustment is material depends upon the facts and circumstances of the particular case, including the amount of the adjustment, its size relative to the general level of the corporation's total assets and annual profit or loss, the consistency with which the practice has been applied, and whether the item to which the adjustment relates is of a recurring or a nonrecurring nature.

(4) For purposes of determining income, necessary translations shall be made at the following exchange rates:

(A) Depreciation, depletion, or amortization shall be translated at the appropriate exchange rate for the translation

period in which the historical cost of the underlying asset was incurred.

(B) All other items shall be translated at either the endof-year exchange rate or at the simple average exchange rate for the translation period. Income repatriated during the year shall be translated at the exchange rate at date of repatriation. It is presumed that the translation rate used in preparing the consolidated profit and loss statement for financial reporting purposes is proper absent a showing that some other method is appropriate.

A change from end-of-year rates or average rates may not be made without the permission of and on such conditions as the Franchise Tax Board may prescribe.

(c) Computation of Factors. In computing the formula factors, the following rules shall apply:

(1) Property Factor.

(A) Fixed assets shall be valued at original cost as defined in Reg. 25130(a) and translated at the exchange rate as of the date of acquisition.

(B) Rented property, capitalized at eight times its annual rental rate, shall be translated at the simple average of the beginning and end-of-year exchange rate.

(C) Inventories shall be valued at original cost and shall be translated at the exchange rate as of the date of acquisition.

(D) For purposes of calculating the property factor of financial corporations, financial assets are translated at the year-end rate and are defined as assets reflecting a fixed amount of currency, such as cash on hand, bank deposits, and loans and accounts receivable. Securities held, or reasonably expected to be held, for less than six months shall be translated at year-end rates. If a security is held, or reasonably expected to be held, for more than six months, it shall be translated at the appropriate exchange rate for the translation period in which the historical cost of the asset is determined.

(E) The property factor shall be computed in the currency of the parent company unless the taxpayer requests and the Franchise Tax Board determines that computing the factor in dollars or any other currency fairly reflects the taxpayer's activities in California.

(2) Payroll and Receipts Factors.

(A) Translation shall be made at the simple average of the beginning and end-of-year exchange rates unless there is a substantial fluctuation, as described in subsection (d)(2).

(B) Where the value of the foreign currency does fluctuate substantially, as described in subsection (d)(2), the exchange rate appropriate to that period shall be either (1) a simple average of the month-end rates, or (2) a weighted average taking into account the volume of transactions (reflected by the amount being translated) for the calendar months ending with or within that period.

(C) In computing the payroll and receipts factors, translation shall be made into the parent company's currency in order to properly determine the percentage factor to be used unless the taxpayer requests and the Franchise Tax Board determines that computing the factors in dollars or any other currency fairly reflects the taxpayer's activities in California.

(d) Exchange Rates.

(1) For purposes of preparing combined reports, exchange rates may be derived from any source which is demonstrated to the satisfaction of the Franchise Tax Board to reflect actual transactions conducted in a free market and involving representative amounts. In the absence of such demonstration, the exchange rates taken into account in computation of the earnings and profits of the foreign corporation shall be determined by reference to the free market rate set forth in the pertinent monthly issues of International Financial Statistics or successor publications of the International Monetary Fund.

(2) In general, the extend of fluctuation is substantial if the closing rate for any calendar month ending within the period

varies by more than 10 percent from the closing rate for any preceding calendar month ending within the period.

(e) Application of Regulation.

(1) In computing the income and any of the factors required for a combined report, the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information. In appropriate cases, such as when the necessary data cannot be developed from financial records maintained in the regular course of business, the Franchise Tax Board may accept reasonable approximations.

(2) A taxpayer may request an advance determination under subsections (b)(2), (b)(3)(C), (c)(1), (d)(1) or any other provision of this regulation by submitting a determination request to the Legal Division of the Franchise Tax Board. Such a determination shall be made on an individual basis and shall be limited to the particular facts or circumstances set forth in the determination request. The facts and circumstances upon which a determination is made remain subject to review. Failure to request or to obtain a favorable advance determination will not preclude consideration of requested variances in subsequent proceedings.